

No. 92-466

Supreme Court, U.S.

FILED

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In The  
**Supreme Court of the United States**  
October Term, 1992

— ♦ —  
**LIGGETT GROUP INC.,**  
now named Brooke Group Ltd.,

*Petitioner,*

vs.

**BROWN & WILLIAMSON**  
**TOBACCO CORPORATION,**

*Respondent.*

— ♦ —  
**On Writ Of Certiorari To The**  
**United States Court Of Appeals**  
**For The Fourth Circuit**

— ♦ —  
**JOINT APPENDIX**  
**VOLUME III, PAGES 548-851**

— ♦ —  
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**Petition For Certiorari Filed September 16, 1992**  
**Certiorari Granted November 16, 1992**

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## KEY

In this Joint Appendix, brackets indicate text added by counsel to inform the Court of appropriate notations or other information not appearing on the face of the document itself. Where the date of a document has been derived by reference to its accompanying testimony, the citation (Tr. \_\_:\_\_) to such testimony has been included with the document's date.

**[Excerpt of Trial Testimony of: W. Burnett - con't]**

Q I show you Plaintiff's Exhibit 236 which is in evidence. And I ask Mr. Barker and Ms. McCarty if they will pass copies out to the jury.

Now, Mr. Burnett, what is Plaintiff's Exhibit 236?

A This is a document titled "The Domestic Competitive Analysis" prepared by the Brown and Williamson Corporation. And during this period, in the area of 1982 through '84, it was prepared on a regular basis or updated with some frequency by Brown and Williamson. And I believe Ms. Olges testified to how some of these documents have been compiled.

For purposes of assessing profitability, if we could turn to pages 82 through approximately 86.

[p. 47-70] Q Are you referring to Bates Page beginning 264415?

A That's correct. And through Bates Number 264419. We see on document page 82 or Bates Number 415 that Brown and Williamson is calculating the corporate financial ratios for each of five - not six but in this case five - of the cigarette manufacturers.

And then on the next page they evaluate the performance of the tobacco activities of those firms, and on subsequent pages they continue their evaluation of just the tobacco activities of those companies.

And while the numbers require some manipulation and interpretation, Brown and Williamson is effectively carrying out the same type of analysis that I did in comparing the performance of tobacco activities of these corporations with the returns earned by the corporations as a whole.



So once again, Brown and Williamson was carrying out the same type of analysis that I did based on the same type of accounting data that I did. It was drawn from publicly available information for each of these companies.

BY MR. HOGELAND:

Q Mr. Burnett, I show you Plaintiff's Exhibit 230A which is in evidence. And I will ask Ms. McCarty to hand copies of that to the jury.

Could you tell me what Plaintiff's Exhibit 230A is, Mr. Burnett?

[p. 47-71] A Plaintiff's Exhibit 230A is a memoranda prepared by Ms. Trina Ogles, a Brown and Williamson employee, compiling and reporting data that had originally been published by the Federal Trade Commission in what was, at the time, called the line of business report.

For a period of time in the mid-1970's, from about 1973 through '77, the Federal Trade Commission compiled a special report of financial data by individual line of business within major diversified corporations throughout the U.S. economy, precisely to get around the problem I had in looking at corporate financial data.

The corporate financial data blends the profits and the assets and the income derived from a number of different lines of business. The FTC at the time in part was attempting to have the corporations break out those assets and that income. And that's what the ---

Q Mr. Burnett, let me show you Plaintiff's Exhibit 3932C and ask you if that is the line of business report about which this exhibit speaks?

A Yes. It is. This was the report published by the Federal Trade Commission for the year 1976 and which is the subject of Ms. Olges' memo in 1983.

Q Can you tell me when the line of business report for 1976 was published, sir?

A This one finally appeared in May of 1982. There was, at [p. 47-72] the time, quite a substantial time lag between whom [sic] the data was compiled and when it was subsequently -- or when it was collected and when it was subsequently put together and published. It was a lot of work.

Q Now going back to Plaintiff's Exhibit 230A, can you explain how that relates to your study of profitability in the cigarette industry?

A Quite honestly, Ms. Olges did the same thing I did when I first started looking at the cigarette industry. Having been at the Commission at the time that the line of business data was being collected, I was aware that this data source existed.

And I went to the line of business reports for each year from 1973 through 1977 to see what information I could garner on the cigarette industry from the L.B. reports.

Ms. Olges is reporting the line of business reports for the cigarette industry on the second page of this memorandum and comparing it to the average for the entire sample of industries that the Federal Trade Commission collected data for.

Now in the 1976 survey that Ms. Olges is summarizing, there were -- if memory serves -- approximately 250



different industry categories that they compiled information for. This data, over until the last column over here on the far side which says "All Manufacturing Average." The rest of the data [p. 47-73] pertains only to the cigarette industry.

And the first line is of particular interest to me. It is the measure of operating income to assets. That is a different measure of the profitability or the profit of cigarette activities.

And you'll see that the cigarette industry earned 24.3 percent as measured by operating income to assets.

The second column is misnumbered or mislabeled. This is really cigarette industry, and it should read "Rank." It is the rank of the cigarette industry within the 250 that were compiled by the Federal Trade Commission, and the cigarette industry ranked Number 12 in terms of profit as measured by this ratio of the 250.

And over in the far right column it shows that the average for all manufacturing as compiled by the Federal Trade Commission's line of business was 12.3 percent or roughly half of the cigarette industry's average.

In the alternative, the cigarette industry was earning roughly double what the all manufacturing average was. Once again, this is similar - a similar type analysis and consistent with the earlier analysis I did myself and that which was reported by Merrill Lynch and that with which was reported in the Domestic Competitive Analysis.

Q Mr. Burnett, do economists in conducting an industrial organization market analysis normally take

into account [p. 47-74] articles that appear in the business press?

A It is information and provides general background that is recognized and use.

Q Did you do that in conducting your study of profitability in the cigarette industry?

A Yes. I used the trade press or magazines and newspapers for both information on profitability and general industry activity.

Q And have you selected any articles in the *Trade Press* as illustrating your analysis?

A Yes. I have.

Q I show you Plaintiff's Exhibit 1380 and Plaintiff's Exhibit 7187, and I ask you if you can describe what they are and the extent to which you consulted that type of information.

A Plaintiff's Exhibit 7187 is an article taken from the Sunday *New York Times* business section on June 12, 1988, titled "Cigarettes: Still Big Business." And it is - it provides general industry background and information on the cigarette industry.

Plaintiff's Exhibit 1380 is an article that appeared in *Business Week* magazine on December 22, 1986, and is titled "Tobacco Company Profits Just Won't Quit."

Those are the two articles that I selected for illustrative purposes.

[p. 47-75] MR. HOGELAND: Your Honor, I move into evidence Plaintiff's Exhibit 1380.

MR. LONDON: If Your Honor would, please, again instruct the jury that this is not being offered for the truth of its contents and they shouldn't rely on its contents to prove the truth of what it says in the article.

THE COURT: All right. Are you going to offer both of these articles, Mr. Hogeland?

MR. HOGELAND: Plaintiff's Exhibit 7187, I believe it is, Your Honor, was, I believe, not in the pre-trial order. So I'm not offering that in evidence.

THE COURT: All right. Well, Plaintiff's Exhibit 1380, the *Business Week* article is something that you looked at and relied in part on. Is that correct?

THE WITNESS: Yes, sir.

THE COURT: All right. Ladies and gentleman of the jury, 1380 is admitted, not for the truth of any statements contained therein, and you shouldn't rely on the article for the truth of any statements therein but admitted as the type of information - public information available which the witness referred to and perhaps relied on.

(The article above  
(referred to was received  
(into evidence as:

(PLAINTIFF'S EXHIBIT  
(NO. 1380.

\* \* \*

[p. 47-78] But, for example, there's a quote here: "They can't live fact on happy anymore." And the last article - and I just wasn't quick enough on it to comment - that in

the Merrill Lynch analyst report this is a well-functioned oligopoly or whatever it is.

I mean, those are quotes by other people and whatever cautionary instructions given the jury, it's the sort of material that under 403 should not be coming in. If he's relying on financial information in here, that's a different story.

And, you know, we're very close to the lunch break. This article is a lot shorter than the other. I have seen it before but not for a long time, and ---

THE COURT: Well, we're taking an awful long time here on these things. I'm going to admit it as something he relied on. If he wants to rely on it and there's some problems on that, you can impeach him on something else.

Let's go ahead.

(End of bench conference.)

BY MR. HOGELAND:

Q Mr. Burnett, what in evidence in Plaintiff's Exhibit 1380 did you take into account in considering the profitability of the cigarette industry?

A Well, the article as a whole I took into account. There are two or three passages which have to do with [p. 47-79] profitability and the pricing structure in the industry.

The very beginning of the article, the first line reads, "The cigarette industry may have big woes, but it also has big profits." And then it goes on to discuss that these big

profits exist even in the face of the declining unit volumes that we've discussed a couple of times.

On the second page you see halfway down the first column the heading "Profits in Puffs." And a little way down there's a quote that begins, "Despite declining sales for the smaller producers, cigarettes are still a highly lucrative business with operating margins that can exceed 25 percent."

And then a quote, " 'Even with modest market share, you can be extremely profitable,' asserts Raymond J. Pritchard, chairman of Brown and Williamson Tobacco Corporation, the U.S. tobacco arm of London based BAT Industries PLC and the nation's third largest cigarette maker."

"Those profits are getting a boost from stable to lower prices for leaf tobacco coupled with a savings rung out of plant consolidations and modernizations."

And then the final passage that bears directly on profitability appears in the first full paragraph in the middle column which begins, "Some industry insiders ---" And it goes on to say, "Some industry insiders worry that the pricing skirmishes that could erupt." Or excuse me. "--- that the pricing skirmishes could erupt into a full-scale [p. 47-80] war."

That's referring, at least in part, in the previous paragraphs to generic cigarettes.

And then they go on to say, "Manufacturers increasingly are shifting marketing dollars into such promotions as two-dollar-discount coupons for cartons. The number

of such promotions quadrupled this year, distributors say. At Philip Morris, the nation's leading cigarette maker, the possibility of a price war is a major concern."

And then a quote, " 'Our biggest worry is that the competition doesn't get stupid,' says Frank E. Resnik, president of Philip Morris, U.S.A."

So in general this article is yet again confirming that the prices and profits in the industry are high and the quote from Philip Morris expresses concern that somebody doesn't get stupid. And to me as an economist that means that the price - that they don't want a price war to break out.

Q Mr. Burnett, you've told us yesterday that there were other forms of rivalry between the cigarette manufacturers besides list price competition. Would you tell us again what they are?

A Well, there are stickers and coupons and buy-one-get-one-free and other forms of free giveaways when new products are being introduced.

[p. 47-81] Q And does that mean that --- Does that reduce the profitability of cigarette manufacturers?

A To an extent, but the key issue to me is whether the extent of the promotional activities offset or compensate for the continual and steady increases in list prices.

And my evaluation of the data available indicates that it does not.

Q Well, Mr. Burnett what degree of competence do you as an economist have in using accounting rates of return to evaluate profitability in the cigarette industry?



A I use them with great caution. There are significant potential differences between the accountant's use of this type of data and accounting profitability and the measure of profitability that economists would, in a sense, prefer to have.

However, this is the data that is regularly available and regularly relied upon. It's used by economists in industry studies. It's used by investors and stock analysts and accountants and the trade press in evaluating a company's profitability.

So that although I recognize that they are potentially flawed and may not be perfect measures of profitability from an accountant - excuse me - from an economist's perspective, they provide significant evidence to me of the high prices and high profits that are earned by the cigarette [p. 47-82] manufacturers.

Q Well, how does an economist's evaluation of profitability differ from accounting reports?

A Well, accountants sometimes treat some forms of expenses as an example. There are a number of ways they may differ, but a very straightforward example is that accountants tend to treat certain forms of expenditures by a company as if they should be written off or deducted from income in the given year in which they are incurred, even though those expenses may have the effect of increasing the prices and the profits of the company over some long period of time.

Probably the best example of that is research and development. When a firm spends money on research and development, the accountant will expense it or

deduct it from income all in the same year, even though that research and development may well lead to sales and profits and revenues out into the future.

The economist would rather see those research and development dollars capitalized or kept as an investment on the firm's books rather than expensed or deducted all in the first year.

Accountants, though, are extremely conservative people. And since it's fairly uncertain as to whether the research and development will ultimately result in income, the firms engage in the R & D in the anticipation that it does.

[p. 47-83] But economists would really prefer to see it capitalized and treated as an investment rather than expensed. Accountants don't do it that way, and that's one possible difference.

There are others. So the data has - the accounting data has to be used with care and caution, and it has to be viewed in context.

And what I've tried to do here is look at a number of different sources and find them all generally consistent with the proposition that the returns to investments in cigarette activities are high.

The prices - and they confirm the position that prices charged for cigarettes are high, are above levels that would prevail in competitive markets.

Q Well, as an economist, what conclusions do you draw from the fact that the cigarette industry profitability is higher than in other - than other industries?

A In conjunction with the other information I've reviewed, including a high concentration and the price leadership and the inconsistent movements in prices and costs and now the profitability – I've reached the conclusion that prices and profits in this industry are above competitive levels and that that provides the motivation or provides or establishes the plausibility of potential predatory behavior on the part of one of the larger manufacturers with respect to Liggett [p. 47-84] and Myers.

Q Mr. Burnett, if there's an absence of competition in the cigarette industry and cigarette companies are making such high profits, why doesn't everybody begin making cigarettes?

A That's a good question because that's how market economies are supposed to work.

When firms in an industry earn profits that are above competitive levels, if the market is functioning properly – new firms will enter that business in an attempt to participate in those high profits that are earning more than you can get somewhere else.

And to an economist the next question is, how easy or difficult is it for new manufacturers to get into that business?

That's termed by economists an evaluation of conditions of entry or barriers to entry. And I looked at that, and I concluded that entry into the cigarette industry is very difficult. It's quite difficult. It has not occurred in many, many years, decades.

And there is good reason for that.

Q Well, Mr. Burnett, as an economist, what would you expect to see happen if entry into the cigarette were easy?

A As long as the profits and the prices are high, if entry were easy, I would have expected to see new firms entering the market to participate in those high profits.

[p. 47-85] If we took as an example again the carpet industry, if for some reason the production of carpet became a very profitable business activity, I would expect to see new firms opening carpet factories with some speed to participate in those high profits.

Q Well, would the conditions of entry in an industry affect an analysis of the plausibility of predatory conduct?

A Yes. It would.

If entry was very easy and occurred quickly in response to the high profits, then in a sense the existing manufacturers would have little to protect in the way of high profits because they were going to lose them fairly soon anyway.

If new firms will enter, then the prices aren't going to stay up here at the monopoly level for very long or at a monopoly-like level for very long because other people are going to come in and compete them away (demonstrating).

So the existence of or the difficulty of entry, the existence of what are sometimes termed "barriers to entry" provides the basis for believing that the high prices and profits will be sustained for a long period of

time and, therefore, that the existing manufacturers will have something to protect and defend.

Q Well, what did you conclude regarding entry conditions in the cigarette industry?

[p. 47-86] A Entry into the industry is difficult. It would take a long time and is unlikely.

Q Well, what do you base that conclusion on, Mr. Burnett?

A Well, it's in part based on a very simple observation, that even the existing manufacturers of cigarettes have a very difficult time successfully introducing new cigarette products.

There are only a few - a handful of products that have been introduced since the early 1970's that have achieved a share of three or four percent. They include, for example, Vantage and Merit which took advantage of the opening of the low-tar and nicotine category of the market. And they included Liggett's generics.

But the fact is that the big winners - the big hitters that achieve three or four percent are rare and unusual.

It's also true that a manufacturer of branded cigarette products cannot succeed in the long run with just a single brand of one percent.

Liggett's experience illustrates that in the late 1970's. As Liggett's share was declining below two and a half percent, it was on the verge of going out of business.

And the reason it was on the verge of going out of business is that one of the things a cigarette manufacturer

has to have to sell branded cigarettes is a sales force out [p. 47-87] there to support the sales and distribution of that product, as well as the requirements of having the manufacturing facilities and all of the overhead expenses to support them.

You can't succeed with just one or two percent of cigarettes sales. And the fact is that it's very hard to get one brand that will get you there.

Therefore, a new firm coming into the market would have to anticipate getting two, three, four successes all in a fairly short time frame or else they're going to be operating at a disadvantage compared to the other firms.

And that just typically hasn't happened. There hasn't been that many big winners.

And not only would a firm outside have to anticipate that they'd have a big winner, but they would have to anticipate before the large existing branded manufacturers anticipated the opening of a new category or the development of a new product that would appeal to a lot of different consumers. And that's just very unlikely.

Further, even if they did anticipate that big winner, it's likely that it would take a long time. If you look at the experience of a couple of the brands that have succeeded in gaining material market shares upward of three and three and a half percent, at least a couple of them took a long time to get there. They were introduced, and they were, in fact, successful brands, in the sense that they got one [p. 47-88] percent, a little more than one percent. That's a success in the cigarette industry.



But it took quite a number of years for even those successful brands to keep up so that they had sales that approximated two or three or four percent. So it's difficult to do. It doesn't happen often. In some instances it takes a long time.

And if a firm outside is going to do it, they've got to anticipate and get in there before one of the branded manufacturers does. That all to me means that it's unlikely that it will occur, and it provides a strong basis for explaining why it has not occurred.

Q Is the fact that industry demand is stable or declining affect new entry?

A Sure can. If you have a market environment where demand is growing. It means that in a sense there is room for the new firm to come in and participate or take sales from the growing market.

On the other hand, if the demand is stable or declining, it means that in a sense there's a fixed number of cigarettes that are going to be sold. And the new entrant has to come in and actually take all of its sales away from the existing manufacturers. That's a relatively more difficult prospect than coming into a growing market where you're likely to take some of your sales from existing manufacturers and also. . . .

\* \* \*

[p. 47-96] and that it's quite difficult. And if it did occur, it would take a long period of time.

So it reinforces my view that in the presence of the high prices and profits, there is something for the existing branded manufacturers to defend.

Q Well, Mr. Burnett, if all of these cigarette firms have something to defend in exercising market power through coordination of activities, why would any of them want to engage in predatory behavior?

A I guess that's the point. Liggett was different, and Liggett had different motivations from the other five manufacturers by the time they introduced generic cigarettes.

As I was just saying, Liggett was on the verge of liquidation. Liggett was almost going out of business. Liggett broke with the traditional patterns of competition in the industry and for the first time in many, many decades used list price as a form of competition to sell its cigarettes.

Liggett was the one firm in the industry that had the strongest incentive to introduce low-priced cigarettes because in doing so it had little to lose in the form of the high prices and profits on branded cigarettes.

It didn't have many branded cigarettes any more. So to the extent it grew the cigarette - the generic category, it was pulling all of its sales from the other manufacturers and [p. 47-97] was suffering relatively little itself.

So there was a very marked difference in the motivations of Liggett and Myers on the one-hand and the other manufacturers on the other. Liggett didn't have anything to protect any more.

MR. LONDON: Move to strike, Your Honor.

THE COURT: Overruled.

BY MR. HOGELAND:

Q I understand your description that Liggett had nothing to protect, but you had mentioned a final and sixth factor in your industrial organization market analysis as the role of Liggett in the industry.

Now what do you consider the role of Liggett in the industry having to do with the plausibility of predation by anybody in the industry?

A Liggett was the spoiler. Liggett broke the rules of the game. In the presence of its declining share, Liggett introduced the generic cigarettes, and that ---

Q Well, Mr. Burnett, what evidence do you have that Liggett was the spoiler or maverick?

A It was, in fact, the firm that was the first firm to use list price as a competitive weapon in decades. It lowered the price of cigarettes to the consumer, and those prices were passed on to the consumer. And those low prices were what motivated, in large measure, the increasing sales of [p. 47-98] low-priced generic cigarettes.

Q Well, is Liggett's action with respect to generics the only evidence that you're relying on to define Liggett's role as a spoiler or maverick?

A No, sir. Liggett's role as the spoiler or maverick really predates generics and goes back to the mid-1970's when they attempted to introduce Eagle.

Eagle, at the time, was intended to be a discount cigarette. And I believe, as Mr. Dey and Mr. Grant both testified, it didn't succeed. And in part it didn't succeed

because they weren't capable of insuring that a significant enough price differential existed between branded product up here and Stride down here (demonstrating) to motivate the consumer to buy the product.

That product didn't succeed, but it indicated in 1975 -- Liggett ---

Q You mentioned Stride. Did you mean to say Stride?

A Excuse me. If I said Stride, I meant Eagle. We're talking about Eagle.

In 1975 Liggett made the first attempt to use a lower list price to sell its Eagle product. It failed. It didn't work. But it was the first indication of their willingness to try it, to make the attempt at introducing a lower-priced product.

They tried again in 1979 with their initial sales to [p. 47-99] Topco for generic cigarettes, and much to their surprise, it succeeded beyond all expectations. And as the Brown and Williamson documents indicate, it had reached a share of approximately four percent, which in volume terms is just a smashing success.

By early 1984 Liggett's role as the spoiler and the price-cutter didn't stop there.

Late last year or early this year they introduced yet another low-priced cigarette, this time the Pyramid product, which they are promoting as selling for about half the price of branded cigarette products.

So Liggett's role as the price-cutter and spoiler really extends over the entire period of 1975 through 1988-89.



Q Well, all right, Mr. Burnett. What does the role of Liggett and Myers as the maverick or spoiler that you have just described have to do with your industrial organization market analysis?

MR. LONDON: If Your Honor please, so that I don't have to keep getting up, may I have a continuing objection to the witness's characterization and to the witness's narrative?

THE COURT: All right, sir.

Go ahead.

A Liggett, as the spoiler, and Liggett, breaking with the rules of the game, provides the motivation for one of the [p. 47-100] larger firms to engage in predatory behavior with respect to Liggett.

It was Liggett that was having the effect of bringing down the price structure. It was Liggett that was having the effect of offering low-priced cigarettes to consumers and drawing those cigarette sales away from the high prices and high profits that were earned on branded cigarettes.

That meant that the larger firms had something to protect and defend, and it was Liggett that was undercutting the high prices and profits and, therefore, provided the motivation for one of the larger firms to come after Liggett in an attempt to slow down the rate of loss of branded sales to there [sic] lower-priced, lower-profit generic cigarette products.

Q Do you consider Brown and Williamson one of those larger firms?

A Yes, sir. I do.

Q Now, Mr. Burnett, do economists normally consider the role of an individual competitor within an industry when conducting an industrial organization market analysis?

A Yes, and specifically it's often called the role of the maverick firm. It's the firm that doesn't go along with the behavior of the other firms in the industry.

Q Do you remember testifying yesterday about the Department of Justice merger guidelines?

[p. 47-101] A Yes.

Q Does that have references in it to maverick firms?

A It doesn't use those words, but it has that --- It conveys the same spirit.

The Department of Justice merger guidelines say specifically that they will be more likely to challenge a merger and prevent industry consolidation and an increase in concentration where one of the firms involved is a maverick or disruptive force in the industry because it's precisely the loss of such a maverick or disruptive force that they're trying to prevent in addition to preventing the increase in concentration that results from a merger among firms that manufacture the same product.

Q Now, Mr. Burnett, did you find anything in any of the Brown and Williamson documents about the role of Liggett and Myers as a maverick?

A Yes. I did.

Q Now I show you Plaintiff's Exhibit 7097 which is in evidence.

MR. BARKER: Yes.

BY MR. HOGELAND:

Q And I will ask Ms. McCarty to give the jury copies of Plaintiff's Exhibit 7097.

Now, Mr. Burnett, can you tell me what Plaintiff's Exhibit 7097 is?

[p. 47-102] A This exhibit was an analysis as titled on the front page, "An Analysis of Price and Value for Money in the Cigarette Market" prepared by BAT, Brown and Williamson's parent corporation in England, of instances of the expansion of the value-for-money category or of price competition in a number of different countries around the world.

Those countries - the countries specifically that are analyzed are mentioned in the table of contents under number five on that first page.

Q Now, Mr. Burnett, that list of companies - countries on the first page, can you tell us what the first one is?

A Well, it's the United States. With respect to the United States and specifically with respect to the role of Liggett as the spoiler ---

MR. LONDON: I don't think there is a question pending, Your Honor.

THE COURT: All right, sir. He's listed the United States.

All right. What is your next question, Mr. Hogeland?

BY MR. HOGELAND:

Q What does it say about price competition in the United States?

A Well, with respect to Liggett as the spoiler on Stamp Number 216491 and, if you can read it, I think it's page 18 [p. 47-103] at the top of the page.

This document specifically recognizes the role Liggett and Myers has had in expanding the availability and sale of generic cigarettes in the United States. And under C, the second heading down on that page, it reads, "Liggett and Myers has been steadily declining for many years. By 1980 its market share was two and a half percent which was almost below the threshold at which they could remain in the marketplace.

"The cost and risk of new product launches plus the economic environment pushed them towards the product development of generics and own label cigarettes.

"Initially they were only 'on test,' but their success, backed by support from a new parent company" - Grand Metropolitan took over Liggett in 1980 - "encouraged further development and growth from 1981 onwards."

So their [sic] BAT is specifically recognizing the role Liggett had had in introducing generic cigarettes.

MR. LONDON: I object, and I move to strike the characterization of what this witness says BAT is recognizing.

THE COURT: All right. I will grant that. If you will just --- The document is in evidence, and the jury can draw their conclusions from that.

All right. Go ahead.

BY MR. HOGELAND:

[p. 47-104] Q Are there other passages and parts of this document about low-priced cigarette competition that relate to your industrial organization market analysis, Mr. Burnett?

A Yes, sir. Several pages further on, on Stamp Number 216494. I believe it's page 21 now. Near the bottom of the page, the second to last bullet at the bottom of the page that begins, "The presence."

And it reads, "The presence of a rapidly declining manufacturer, Liggett's, was important in the U.S. situation and is repeated in many other markets around the world. Its acquisition by Grand Metropolitan in 1980 was also a key factor in the traditional tobacco marketing strategy. It's also a key factor in that traditional tobacco marketing strategies were put aside."

Q And, Mr. Burnett, that bullet appears under the heading "Conclusions." Is that right?

A That's correct.

Q And that is conclusions with respect to what?

A It's their conclusions with respect to their analysis of price and value-for-money in the cigarette market, specifically with respect to competition in the United States.

Q Now, Mr. Burnett, are there other parts of this document that relate to your industrial organization market analysis?

A Yes. There are some summary statements back on page 12 [p. 47-105] of the document which is Stamp Number 216485.

Q And this is page 12?

A Page 12.

Q And you are referring to the page that begins, "The ideal preconditions"?

A That's correct. This is a summary of the lessons ---

MR. LONDON: Object to what it is, Your Honor. If he wants to read from the document in evidence on which he relied, Your Honor has ruled that he may do that. But I believe he may not tell us what it is he thinks the purpose or the meaning or the significance of the document is.

THE COURT: Well, I don't know whether he was going to tell us that or not, but you can go ahead.

I did not hear what you said or were going to say.

Is there a question, Mr. Hogeland? And you referred him to that page. What about it?



BY MR. HOGELAND:

Q This page begins, "Ideal preconditions." Is that right?

A Yes. It does.

Q Preconditions to what?

A As I interpret it, it is preconditions ---

MR. LONDON: Object to this, Your Honor.

THE COURT: Well, the document is in evidence. There is a possible problem with him interpreting documents. "Pricing Value of the Cigarette Market" appears to be the [p. 47-106] heading.

Go ahead. I'll let you testify to that. Go ahead.

A Let me just read what the document says then. The document is about the pricing value-for-money category of the cigarette market.

And they write under a heading titled "The Ideal Preconditions." Quote, "Experience tells us that every market has its own peculiarities which render it unique, but there are some common threads which suggest that the value-for-money phenomenon is most likely to occur when some or all of the following conditions exist." And then a colon.

And then if we look down, several of these preconditions are consistent with the observations I have already made about the cigarette industry in the United States including the one bullet about halfway down that says, "Where industry profit margins are high." And the next one, "Where one or more company is under pressure

from seriously declining market share." And the next one, "Where an aggressive or new competitor exists." And the next one, "Where a non-tobacco company buys an existing tobacco company," which is precisely what happened in 1979 or 1980 when Grand Metropolitan purchased Liggett and Myers.

Those are the preconditions that BAT set forth in their analysis of price and value-for-money in the cigarette market.

[p. 47-107] BY MR. HOGELAND:

Q And what role did you conclude that Liggett's position in the cigarette market played in your analysis of whether or not predation in the cigarette industry was plausible?

A Liggett's role as the price-cutter and Liggett's role in the use of list price competition provided the basis for one of the firms wanting to engage in predatory behavior with respect to Liggett.

Liggett was bringing down or held the potential to bring down the industry price structure which, at the time, was charging consumers high prices and was earning the manufacturers high profits.

MR. HOGELAND: Your Honor, this would be a good place to break for lunch.

THE COURT: All right.

Ladies and gentlemen, it is now 12:30, and there's a matter during lunch that the Court will have to consider with counsel. So we are giving you until 2:00 today.

Please remember what I have told you about keeping an open mind on the case and not discussing it.

Please leave your documents there, and I think we will be ready to resume at 2:00 o'clock.

All right, Marshal.

(Jury out at 12:30 p.m.)

THE COURT: All right. Now remember, some of you

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[p. 47-109]

AFTERNOON SESSION  
2:05 o'clock P.M.

THE COURT: All right, gentlemen. Anything before we bring the jury back in?

MR. LONDON: Our first team is still down with the Magistrate, but we'll plug ahead as best we can, Your Honor.

THE COURT: All right.

Marshal, if you would, please.

(Jury in 2:05 P.M.)

THE COURT: All right, Mr. Burnett, if you would come back, please, sir.

All right, Mr. Hogeland.

MR. HOGELAND: Thank you, Your Honor.

BY MR. HOGELAND:

Q Now, Mr. Burnett, before the lunch break, you had completed your sixth and last point of your Industrial Organization Market Analysis which was the role of Liggett in the cigarette industry. Now as an economist,

Mr. Burnett, what conclusion do you draw from the – all the six factors in your industrial organization market analysis?

A Very simply, that given the presence and the exercise of monopoly power or market power exercised by the large manufacturers of branded cigarette products, that the larger manufacturers with a significant stake in branded cigarette sales had the motivation to engage in predatory behavior. [p. 47-110] That establishes for me the plausibility of predatory behavior, and I guess the second point is that it made rational economic business sense to target Liggett and Myers as the target of predatory behavior because Liggett and Myers was having the effect of reducing cigarette prices by having introduced generic cigarettes in the early 1980's.

Q Well, Mr. Burnett, why in your opinion would predation by Brown and Williamson against Liggett and Myers have made sense?

A The large manufacturers of branded cigarettes were in a sense jointly sharing market power. The prices for all branded cigarette products were high and were being held above competitive levels, so all of the manufacturers who had a significant stake in branded cigarette sales had high prices and profits to defend. Brown and Williamson was one of those firms and, therefore, Brown and Williamson had high prices and high profits to defend. And those high prices and high profits were being undercut by the expansion of generic sales by Liggett and Myers. Liggett was drawing sales from Brown and Williamson which were earning Brown and Williamson substantial prices and margins and profits.

Q Well, Mr. Burnett, isn't it true that in the textbook model of predatory behavior predation makes sense only where a firm has a dominant market share?

A That's a textbook model of predatory behavior, but it [p. 47-111] pretty much misses the more general point. The essential feature, the essential quality that must occur for the rational exercise of predatory behavior by a firm is either the current existence of market power and the existence of prices that are already above competitive levels and therefore those prices may be – the effort would be to maintain those prices at the above competitive levels. Or the prospect of somehow gaining market power and in the future raising the prices to above competitive levels.

So while the textbook model of predatory behavior is usually formed in the context of a single firm with a very large share, that is by no means necessary for the rationality or for the plausibility of predatory behavior. The essential feature of it is the existence of and potential exercise of market power and in this instance the market power is jointly exercised by all of the larger manufacturers of branded cigarettes.

Q Well, Mr. Burnett, does it really make sense for a firm with as little as ten or twelve percent of the cigarette market to invest in predation?

A Yes, it does. Brown and Williamson, even though it had a share of quote, "only," closed quote, ten or twelve percent, had literally hundreds of millions of dollars at stake in their sales of branded cigarette products, and although they may have had less at stake in total terms than one of the [p. 47-112] larger manufacturers, the

amount of money at issue was huge. Hundreds of millions of dollars. So as long as they could protect and defend those hundreds of millions of dollars from imperision [sic] by Brown and Williamson, even though they weren't the largest firms, they still had material significant excess or monopoly profits to protect and defend and that provides them with an incentive and a motivation to go out and defend them to the extent they perceived they're being harmed.

Q Well, for predation against Liggett to succeed and permit the creditor to recoup that investment, would it be necessary to drive Liggett out of business or out of the generic segment?

A No. Predatory behavior can be successful on the one-hand if the firm – the price cutter is driven out of business, that would certainly be the ultimate. But it can also succeed simply by disciplining the competitor. In the context of generic cigarettes, indeed, all that is necessary is that the rate of growth in generic sales be reduced or slowed down. Even if generic sales continue to rise, if the behavior of one of the larger firms had the effect of changing the pattern of increase in sales or the trajectory of increase in sales so that they didn't grow quite as fast as they otherwise would have grown, in an opportunity cost sense, the firm engaging in the predatory behavior, loses less than they otherwise would have.

[p. 47-113] If we assume that no action is taken and Liggett grows the market by a percent a year, the firms lose a lot of money. If one of the firms take action and it costs them 15 or 20 million dollars to discipline and chasten Liggett as the maverick firm, and they slow that



rate of loss down to only half a percent a year – half a percent growth a year, then they've slowed down their rate of loss or rate of erosion in branded sales by half a percent. That's three hundred – or excuse me – that's three billion cigarettes. And the margins earned by the branded manufacturers on three billion cigarettes is a healthy substantial big chunk of money. So they don't have to put Liggett out of business. They don't have to absolutely reduce sales. Technically, all they have to do is slow down the rate of growth in generics and it would pay off.

Q Mr. Burnett, you used the term "opportunity cost." Can you tell us what you mean by "opportunity cost"?

A Well, in this sense, it's just a comparison of what the losses to the branded manufacturers would have been if they had taken no action in contrast to what the losses would be if they took action. And the point is that all they have to do is reduce the rate of growth by a little bit, from say a percent a year to a half a percent a year, and they avoid losing the extra half percent and therefore it would pay off. It would be worth the candle. They'd invest 15 or 20 million [p. 47-114] dollars, and as long as they avoid losing an even greater amount of money, it was worth it to them.

Q Well, Mr. Burnett, did Brown and Williamson analyze the market conditions it faced in 1983 and 1984?

A Yes, it did.

Q And do the Brown and Williamson documents created during that analysis contain economic facts about

the cigarette industry and Brown and Williamson's role in it and Liggett's role in it?

A Yes, they do.

Q Mr. Burnett, do economists regularly study and analyze business documents to understand the company's policies?

A Yes, on a regular basis.

Q Did you study and analyze B & W's documents and testimony?

A Quite extensively. Yes, I did.

Q What kind of business documents do economists pay attention to in doing that type of analysis?

A You pay attention, in essence, to the material that's available and the information one has available, but the weight one accords to documents is, at least in part, a function of who wrote them, who they were directed to, and what background and knowledge and information the author had when they wrote the document. For example, if a document is authored by the president of a corporation or the vice

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[p. 47-121] Q What were the key features of Brown and Williamson's market analysis, Mr. Burnett?

A Well, not surprisingly, given the issue we have at hand, they key features of Brown and Williamson ---

MR. LONDON: Move to strike the "not surprising."

THE COURT: Well, let's don't --- Let's just say answer the question without speculating to that extent, please, sir. Go ahead. The key features were ---

A The key features that I focused on focused on Liggett and Myers' role in the generic category. The effect Liggett and Myers expansion of generic sales was having on Brown and Williamson and general activities within the generic cigarette category. I classified them into five general broad groups. The first involved consideration of the role Liggett and Myers generic cigarettes use of list price competition was having on the market and the distinctions that were drawn by Brown and Williamson between the use of list price and other forms of price competition.

The second has to do with the observations concerning Liggett and Myers commitment to the generic cigarette category and indeed their commitment to continue to drive or to expand the availability and size of the generic cigarette category absent some actions taken by some other firm.

The third category has to do with Brown and Williamson's observations of their losing more than their fair share of [p. 47-122] sales to Liggett and Myers generic cigarettes and the fact that if their loss of sales continued, the losses that they would incur would run into the hundreds of millions of dollars.

The fourth has to do with the observation that Liggett and Myers was so dependent on its generic cigarette sales, that it would vigorously defend those sales. That it was important to the future existence of the corporation. But that was tempered by the observation that the

resources that Liggett had available to it were limited and that Liggett would not be able to withstand a concerted competitive attack for an indefinite period of time. They didn't have the financial support and backing to continue its commitment to the generic category if it was seriously threatened.

And finally was the observation that a key feature of Liggett's program to expand the availability and sales of generic cigarettes was in maintaining and, whenever possible, increasing the price spread or gap between the price of branded cigarettes and the price of generic cigarettes. So in my economic analysis, those are the five key features that I identified in Brown and Williamson's corporate documents.

MR. HOGELAND: Your Honor, at this time, I'd like to ask Ms. McCarty to circulate to the jury a binder of documents, all of which are in evidence.

THE COURT: All right.

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[p. 47-143] A Yes, I have.

Q What others are there?

A Well, the next one is - this time it is behind Tab Number Five, Plaintiff's Exhibit 5. The document written in mid-March 1984. And turning to the second page of the document, Stamp Number 086985, about halfway down the page, the document reads, "Unchallenged, L & M could continue its total dominance of this segment and grow to a total company share of over 15 percent by 1988, becoming the third largest company in the U.S. cigarette market, stipulating that the industry's interest, other than



L & M's would be far better served had generics never been introduced. They are an immediate and growing threat to all other manufacturers. Competitive counteractions are essential and inevitable."

And then continuing on under number three, "Competitive Response. Generic growth represents volume erosion for all competitors. Unchallenged, L & M will continue aggressive segment development since it has virtually no stake in the branded full price market. All other manufacturers face a shrinking industry and eroding share in volume as generics grow."

Q Now, Mr. Burnett, in your own market analysis did you conclude that generic cigarettes were a threat to all other manufacturers?

A Yes, sir. I did.

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[p. 47-148] conclude, further down the page, under the heading "Competitive Activity" it reads, "Generic growth represents volume erosion for all competitors. Unchallenged, L & M will continue aggressive segment development since it has virtually no stake in the branded full priced market."

Q Mr. Burnett, are those packages[sic] that you just read from, the domestic competitive analysis, consistent with your own industrial organization marketing analysis?

A Yes.

MR. LONDON: Objection.

THE COURT: Overruled.

A Yes, they are.

BY MR. HOGELAND:

Q Now, Mr. Burnett, you testified that the third key feature that you discerned in B&W's market analysis was that Brown and Williamson was losing more than its fair share, and that if that loss continued it stood to lose millions of dollars. Are there documents in Brown and Williamson's market analysis that illustrate that key feature, Mr. Burnett?

A Yes, there are. In large measure, they're drawn from the same documents I've been reading from.

Q Can you tell us what they are?

A Yes, sir. The first one appears in PX-2, tab two, once again, the February 9 overhead presentation. And the point

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[p. 47-151] A Yes, sir. Turning to tab five, Plaintiff's Exhibit 5, again, the March 9 Brown and Williamson generic proposal. On the second page of that document, stamp number 086985, in the third paragraph down the page, Brown and Williamson wrote: "B&W's contribution to generics was disproportionately high. Specifically, B&W contributes about 70 percent more than its fair share volume to generics. B&W losses account for about 21 percent of generic's gains. In 1983 B&W lost about 3.7 billion sticks to generics, a variable margin loss of over 50 million dollars. By 1988 this loss could total 18 billion sticks, and about 350 million dollars loss of variable margin."

And then down at the bottom of the page, it reads, "1988 - '83 Losses to Generics." "For perspective, in 1983 cigarette companies lost approximately the following volumes and variable margin to generics." And then there appears, at the top of the next page, a table which is repeated in a number of other Brown and Williamson documents, which basically shows where Brown and Williamson got the Fair Share Loss Index of 170. B&W was listed as the second firm down the table, and reading across to the second column, it says, "Fair Share Loss Index," and B&W's is 170.

What that means is that Brown and Williamson was - Brown and Williamson had a share of 11 or 12 percent, yet it was contributing more than 11 or 12 percent to generic sales.

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[p. 47-157] THE COURT: Okay. Well, that's where illustrations come from. Let's don't have him go through 13,000 documents.

MR. HOGELAND: That's my whole point, Your Honor. He has selected these to illustrate those which he relies on.

THE COURT: Okay.

MR. LONDON: That's my understanding of the question.

THE COURT: Okay. That's fine. Let's sit down before we have an argument.

(End of Bench Conference.)

BY MR. HOGELAND:

Q Now, Mr. Burnett, before you were interrupted you were answering my question as to what, if anything, in Plaintiff's Exhibit 7098A illustrates the statements in Brown and Williamson's documents on which you rely for your conclusion that a key feature of its market analysis was that B&W was losing more than its fair share and stood to lose millions of dollars, or your first two key features, that Liggett was committed to the segment and continued to grow it and had a motivation to do it, or that price competition was new in the cigarette industry.

A Well, there are two key passages that highlight the role of price competition in the sale of cigarettes. The first appears in Mr. Kellegher's cover letter under the caption --- about three-quarters of the way down the page - entitled, [p. 47-158] "Pricing and Value for Money," where it reads, "The policies - " meaning, Brown and William [sic] - or BAT Company's new market expansion strategy paper policies. "The policies place a much greater emphasis upon the need to avoid price competition whenever possible and to undertake it only after careful evaluation of the consequences."

And then, subsequently, on page 14 of the document itself --- Excuse me. Thirteen. Page 13, at the very bottom. I believe it's stamp number 183883. At the very bottom of the page under "Policy."

"Every effort must be made to ensure that the industry operates and competes within a rational and profitable price structure." And then carrying over, "Operating companies will not lead or preempt down-trading other than in very exceptional circumstances, and with BAT

Company board approval. Operating company resists, wherever possible on an industry basis, the contract manufacturer of own label or generic cigarettes. No such manufacture should take place without BAT Company board approval."

"Price, slash, value for money offers will be avoided if at all possible; however, competitive moves of this nature should be countered swiftly and dominantly where failure to do so can be shown to be detrimental to the company's market position and profitability in the longer term, and after careful evaluation of all the consequences, including further [p. 47-159] competitive reaction."

"Efforts to maximize contribution by shaving product costs should be - " excuse me - "should be pursued, but without compromising consumer preference."

MR. HOGELAND: Now at this time, Your Honor, I would like to pass out to the jury another binder of documents, all of which I believe are in evidence. Is that right?

THE COURT: All right.

BY MR. HOGELAND:

Q Now, Mr. Burnett, you told us that the fourth key factor in Brown and Williamson's market analysis was that Liggett would vigorously defend its generic business but lacked the resources to withstand a competitive attack. Have you selected from Brown and Williamson's market analysis documents, those documents which illustrate the kinds of statements in there on which you relied for your conclusion, with respect to that key feature?

A Yes, I have.

Q Could you tell us what they are?

A Yes. The first one is in Plaintiff's Exhibit 9, behind tab 9 in the binder.

Q And what is Plaintiff's Exhibit 9, Mr. Burnett?

A It's a Brown and Williamson document entitled, "The Generic Cigarette Category."

\* \* \*

[p. 47-162] that document, stamp number 095662 - really, the entire page and a portion of the next page is pertinent to this point.

MR. LONDON: May I just have that Bates Number again, please.

THE WITNESS: 095662.

MR. LONDON: Thank you, sir.

A "Generic Competitive Response: This section discusses possible competitive responses to the generic cigarette - generic segment." And then it heads it, "Liggett and Myers."

"In the absence of any direct competition, L&W [sic] will continue to build the generic category. It is almost certain that if Brown and Williamson entered the generic segment, Liggett and Myers will react vigorously. Generics represent about 60 percent of L&M's volume. Without generics, L&M's tobacco business would be irreparably damaged."

The next bullet is, "Liggett Can React. While Liggett may have more short-term capacity problems than any



other company in the industry, if they continue to increase market share, we know that they have ordered 17 high-speed cigarette makers, and that would provide them with more than four incremental marketing - with more than four incremental market share capability. The delivery schedule for this equipment is not known."

"We believe the following competitive scenario may be the most likely. One. L&M first meets Brown and William [sic] - [p. 47-163] Brown and Williamson's offer in the military and categories - in the military and categories one and two."

Just as an aside, categories one and two involve volume categories that B&W had laid out, and categories one and two involve purchasers who had purchased in the highest volume categories, or customers that made the largest volume categories - largest volume purchases. Excuse me.

"In addition, L&M may add full taste, kings and 100's to their product line and expand sales support. Expansion into full taste could pose a particular threat to Kool. If this happens, we believe Brown and Williamson still has a good chance of securing generic volume, due to our ability to provide better service and the belief that distributors and chains would prefer doing business with us because of our size and perceived stability."

"Brown and Williamson would match L&M's move to a full product line. If L&M goes to full sales support, Brown and Williamson would match customer service through one or more of the following: Temporarily borrowing the B&W sales force and possibly blitzing at

wholesale, slash, retail, increase permanent part-time help, and seeking additional broker resources."

Then briefly following on to the next page, page 54, under number three, it writes, "As such, under all likely scenarios, B&W stands to capture a major part of the segment. [p. 47-164] We would not expect L&M to be able to maintain any loss position long-term."

Q Now, Mr. Burnett, is there anything in the March 9th Brown and Williamson document that illustrates your point that B&W's market analysis showed that Liggett would react vigorously but had limited resources?

A Yes. In tab five, Plaintiff's Exhibit 5, once again the February - March 9 Brown and Williamson generic proposal. Turning to pages ten - ten and eleven. On page ten, half-way down the page it reads, "Liggett and Myers' Response. In the absence of direct competition, Liggett and Myers will continue to develop the generic category. When any cigarette competitor enters the generic category, L&M will almost certainly react vigorously. To survive a competitive entry, L&M can be expected to minimally match the competitive offer at least in the military and their largest volume accounts. Further, L&M may spend down to full variable margin, i.e., zero profit."

"Conservatively accepting the generics will attain about two million units in 1984 ---"

Q I'm sorry. That's "24 million."

A Excuse me. "--- about 24 million units in 1984, of which L&M might secure 20 million. It would cost L&M an additional 35 to 45 million dollars in lost variable margin to defend its business, assuming a competitor

entered in June and [p. 47-165] Liggett defended in the third and fourth quarter, and first by matching and then by going to a zero profit position."

Q Now, Mr. Burnett, your independent market analysis. Would you conclude that it would cost Liggett and Myers money to defend its position against a competitor who offered a lower price and then went to a zero profit position?

MR. LONDON: I did not understand that question, Your Honor.

THE COURT: Well, you may restate it, if you want to. I think I understand it, but go ahead and restate it.

BY MR. HOGELAND:

Q Do you understand, Mr. Burnett?

A I believe so.

Q Would you answer it, please?

MR. LONDON: I object to the form of the question. I would like to be able to follow it. I'm trying hard as I can.

THE COURT: All right. Go ahead and repeat it, if you would, Mr. Hogeland.

BY MR. HOGELAND:

Q Mr. Burnett, in your independent analysis of the cigarette business and the generic cigarette business, did you reach a conclusion that it would cost Liggett and Myers money to defend its business if a competitor entered and went down to a zero profit position?

\* \* \*

[p. 47-171] Q Now, Mr. Burnett, when we broke, you were testifying about the Brown and Williamson market analysis documents that you had selected, illustrating the feature that Liggett would vigorously defend its generic volume but lacked the resources to withstand a competitive attack, and I believe you were on Plaintiff's Exhibit 5, which is tab five in your book at the top of page 11. Can you tell us what on that page illustrates that key feature?

A Yes, I can. Just a review. This is the March 9 Brown and Williamson generic proposal, and at the top of page 11 Brown and Williamson wrote, "Brown and Williamson would be prepared to match any improvement in service level or line extension. If L&M goes below full variable margin, Brown and Williamson would not match their offer. We would not expect L&M to be able to maintain a loss position for any extended period of time."

Q Now were there additional documents ---

MR. LONDON: I believe it says Brown and Williamson would not plan to match their offer.

THE COURT: I thought that's what he read. Maybe he didn't.

MR. LONDON: I thought he left the word "plan" out, but perhaps I'm wrong.

THE WITNESS: That's certainly there.

BY MR. HOGELAND:

[p. 47-172] Q Now were there other documents which you selected from Brown and Williamson's market analysis to illustrate that point?

A Yes, sir. In Plaintiff's Exhibit 6, which is behind tab number six in this volume, this is the "Brown and Williamson 1984 Strategic Plan and Ten Year Forecast," written on March 9, 1984, from Mr. McDonough, who I believe was the vice president for finance. If you turn to page 12 of the document, stamp number 147823, at the bottom of page 12, Brown and Williamson wrote, "In the absence of direct competition, Liggett and Myers will continue to develop the generic category. When any cigarette competitor enters the generic category, L&M will almost certainly react immediately and vigorously. However, it is unlikely L&M can, in fact, be prepared to engage in a sustained battle because it does not have the financial resources of others in the industry."

Q Are there other documents that you selected ---

A Yes, there are.

Q --- to illustrate that same point?

A Yes, there are, in Plaintiff's Exhibit 7, again behind tab seven of this document. This is a document we looked at earlier for purposes of evaluating the inconsistency of changes in prices and cost, and it was written by Mr. Blott, Senior Vice President of Liggett - excuse me - Senior Vice President of Brown and Williamson, on March 22, 1984. On [p. 47-173] page three of that document, stamp 087133, very briefly Brown and Williamson writes at the top of the page, "L&M will attempt to retain this

business but lacks financial strength to cover all fronts on a sustained basis."

Moving on, there was another reference to the same point. In Plaintiff's Exhibit 41, once again behind tab 41 --- Excuse me. That's incorrect. It's Plaintiff's Exhibit 10, the next document behind tab ten, a memo written by Mr. Fulk, who reported to Mr. Parrack, a vice president and who was the head of the generic's team. On pages four and five of that document ---

Q Excuse me, Mr. Burnett. What's the date of Plaintiff's Exhibit 10?

A Mr. Fulk wrote that document on April 26, 1984, and on the bottom of page four under B, Cons, number one, "This proposition may ---"

Q Mr. Burnett, can you tell me what the word "con" is referring to there?

A Yes. It's one of the cons or the negative aspects of generic, black and white and private label sales. If you turn back to page three, one can see that they are reviewing the details of the generic black and white private label enterprise for Liggett - for Brown and Williamson. It's on the bottom of page four and carrying over onto five. They write, "From the perspective of L&M, we would be competing [p. 47-174] directly with the major part of their total business. If a price war erupted, and if lower prices were passed on to the consumer, widening the price gap between generics and premium cigarettes, there is the possibility of increasing cannibalization."



Then moving over to the next page to number three, it reads, "Legal risks may be somewhat greater with this concept" - meaning black and white and private label generics. "To the extent that Brown and Williamson's offerings will be similar to L&M, we risk legal actions by that company."

And then number four, "While we are convinced that we can replace L&M because we will offer significantly better terms, there is obviously no guarantee that customers will take B&W's generic offerings, particularly if L&M matches or exceeds our terms."

Carrying on, the next reference appears in Plaintiff's Exhibit 31, behind tab 31. These were notes from the Project Volume Task Force meeting, dated Tuesday, May 22, 1984.

Q Excuse me, Mr. Burnett. What does project volume mean?

A Project volume, as I understand it, is the generic enterprise or Brown and Williamson's consideration of launching a generic cigarette. On the second page of that document or note at the very bottom of the page, "B&W fully expects L&M to file suit and to fight price competitively."

[p. 47-175] And then moving on once again to Plaintiff's Exhibit 61, behind tab 61, a memo from Mr. Diebold to Mr. Heger. Mr. Diebold was the Senior Financial Analyst, and Mr. Heger was the Chief Financial Officer of the firm.

Q And what's the subject of that memorandum, Mr. Burnett?

A It reads, "Liggett's Strategy in Regard to Generics," and it was written on July 26, 1984. On the third page of the document, Mr. Diebold writes in the summary, "Turning to the direct question asked, i.e., what will Liggett do and how long can they hold on, my thoughts are as follows. First, we already know that Grand Met is attempting to dispose of the tobacco business. The entry of B&W into the business has driven down the potential price for the business and has spoiled the financing for the leveraged buy-out. While the Liggett group is no doubt mad as hell and may desire to do anything to stop B&W, from Grand Met's viewpoint, they need to find a buyer and protect the potential selling price as much as possible. I would doubt that they would allow Liggett to continue to meet and beat our cigarette selling prices and will probably attempt to raise prices as soon as possible.

"In short, I believe that they have or will shortly decide to share the market with B&W and others. In the meantime, they will probably continue to search for a buyer. I fear that if B&W does not purchase Liggett, they could be [p. 47-176] sold to someone such as U.S.T. or Culbro.

"As to Liggett's staying power, if B&W continues to cut prices, they will be forced, in the short term, to meet our prices but not to beat them. They would count on B&W increasing price around the first of the year or sooner. If they can't find a buyer at any price, their long-term strategy would be to milk the entire business."

And then he closes by saying, "If I can be of further help, please let me know." Again, that was in July of 1984

after Brown and Williamson had introduced their generic cigarettes.

And finally, in document 83, behind tab 83 --- Excuse me. I'm wrong once again. It's document - Plaintiff's Exhibit 901, behind tab 901, the last one in the book. That is an internal memoranda from Mr. Parrack, the head of the Generic Task Force, to Mr. Sandefur on March 27, 1985, roughly nine or ten months after Brown and Williamson introduced its generic cigarettes. Turning to page five of that document, stamp number 086942, at the bottom of that page under, "The rest represent only two key questions. Will Grand Met keep Liggett afloat after June? Will Lorillard figure out what's right with Newport and apply that learning to new products? The first is the one that matters to us. How will Grand Met deal with a cash drain? Divest? Manage prices up? Fight to the death? Lacking financial data on [p. 47-177] Grand Met, we cannot project their actions."

Those are the references I believe - or I selected to illustrate the point concerning the vulnerability of Liggett to a sustained attack on their generic cigarette business.

Q Now, Mr. Burnett, the fifth key feature that you testified to that was contained in B&W's market analysis - was Liggett's part in expanding the generic cigarette category through maintaining and increasing the gap or the spread between branded cigarettes and generic cigarettes?

Now, Mr. Burnett, you selected documents from Brown and Williamson's market analysis to illustrate that point?

A Yes, I did.

Q Can you tell us what they are?

A Yes. The first one is included in Plaintiff's Exhibit 9, again behind tab nine. It is the document entitled, "Generic Cigarette Category." And if you turn to page 068640, page 13 of the document, the second bullet on the page reads, "Starting in 1983, L&M abandoned their previous low-profile marketing strategy and pursued a more aggressive plan encompassing in-store and media promotion, which included ---" and then another bullet "--- widening and emphasizing price difference between branded cigarettes and generics when Liggett decided not to raise generics prices."

That highlights a key feature of Liggett's proposal, of Liggett's generic enterprise. Liggett did not raise price [p. 47-178] when the tax increase went into effect in 1983. This is a clear reflection of the understanding of industry members that they did not raise price, kept the price down, and that was a key feature involved in increasing the sales of generic cigarettes.

There is also reference to this issue in Plaintiff's Exhibit 4, behind tab four. Once again, this is the write-up to the February overhead presentation written in late February or early March, and on page 15 of that document - the stamp number is 095624 - at the top of the page, "L&M Generic Strategies. L&M rapid development in the generic segment has resulted from a number of key strategic decisions. These include, one, taking advantage of marketplace dynamics by widening the price differential between branded cigarettes and generics. When L&M chose not to raise price during the general price increase



in December 1982, July 1983 and again in December 1983, at which time the federal excise tax was doubled, share gains were immediate and dramatic."

Once again, clear recognition that the increase in the price gap when Liggett chose not to raise prices on generics dramatically fueled the expansion of generic cigarette sales.

MR. LONDON: Motion to strike as to what it's a clear recognition of, Your Honor.

THE COURT: All right. The jury will disregard [p. 47-179] that last remark. They've got the document before them. Go ahead. Next question.

A The final document that illustrates this point regarding the effect of the price gap between branded and generic cigarettes appears in document 83, behind tab 83. This is a memorandum.

BY MR. HOGELAND:

Q Can you tell us what that document is, Mr. Burnett?

A This is a memorandum from Mr. Sandefur to Mr. Frigone, an executive of BATUS, the U.S. parent or superior company to Brown and Williamson, on March 21, 1985. And on page ten of that memorandum, stamp number 078501, Mr. Sandefur wrote, towards the bottom of that page, "L&M has limited cash, slash, resource availability."

And then under "Strategic Direction," "L&M will try to survive by ---" and then several bullets "--- raising prices on generics, sharing the generic segment with

B&W, other niche marketing ---" and then new bullets "--- mid-price products and ethnic products." And then a new bullet, "Grand Met will continue to try to sell L&M."

Those are the selections I picked to illustrate the importance of the price gap between branded cigarettes and generic cigarettes in expanding and fueling the growth of the generic category.

Q Now, Mr. Burnett, based on Brown and Williamson's market [p. 47-180] analysis, do the B&W documents set forth a plan or program by which a company might enter the generic cigarette business?

A Yes, it did.

MR. LONDON: Objection and motion to strike.

THE COURT: Overruled.

BY MR. HOGELAND:

Q On the basis of your analysis of that plan and program, do you have an opinion as to whether or not, if implemented, that plan or program had a reasonable possibility of injuring competition?

A Yes, I do.

MR. LONDON: Objection.

THE COURT: Overruled.

BY MR. HOGELAND:

Q What is that opinion?

A That if implemented the program described in these documents had a reasonable possibility of injuring competition.

Q Mr. Burnett, what are the elements or factors in that program that lead you to that conclusion?

A There are several. The first element of the program is a proposal to match list price, but in a sense to beat Liggett's price by offering volume rebates that differed according to the volume of purchase that were discriminatory in that they granted higher rebates to larger volume [p. 47-181] purchasers. This was adopted in part to prevent the price decrease that would accrue to the direct buying customer from B and ---

MR. LONDON: Motion to strike as to the purpose of its adoption, Your Honor. This is precisely the point that we discussed before.

THE COURT: Well, sustained as to why it was adopted unless you've got some specific document that is in evidence that you rely on and make reference to.

THE WITNESS: There will be, Your Honor.

BY MR. HOGELAND:

Q Can you tell me --- The first element on which you relied in your conclusion was a program to match the list price but beat through discriminatory rebates. Is that right?

A That's correct.

Q And what was the next element?

A The next element is essentially one that is intended to narrow the price spread or the gap between branded and generic cigarettes to either reduce the rate of growth of generic cigarettes or, if possible, to actually decrease the sales and availability of generic cigarettes.

Q And what was the third? What was another factor that you found in that program and on which you based your conclusion that, if implemented, it would injure competition?

[p. 47-182] A The discriminatory rebate structure that was adopted or that, if adopted, would have harmed competition was a form of predatory behavior which, if adopted, would have had the effect of minimizing ---

MR. LONDON: Motion to strike.

THE COURT: Overruled.

A --- would have had the effect of minimizing the cost of engaging in predatory behavior.

BY MR. HOGELAND:

Q And were there any other factors that you found in that program on which - as revealed in the documents - on which you based your conclusion that if implemented it would have the effect of injuring competition?

A Yes, sir. The final one is that, if adopted, the program would have had the effect of setting prices below the average variable costs of producing and distributing generic cigarettes.

Q All right, Mr. Burnett. Going back to the first factor that you listed, the program of matching list price but beating Liggett through rebates. Are there Brown and Williamson market analysis documents that illustrate this element of the program?

A Yes, there are.

Q Can you tell us what they are?

A The first one is Plaintiff's Exhibit 275, which is the. . . .

\* \* \*

[p. 47-195] MR. LONDON: That's not - if Your Honor please, we've been over this so many times.

THE COURT: We are getting into intent again. Go ahead, Mr. Hogeland, and try one more time to ask the question, please, sir.

BY MR. HOGELAND:

Q I'm not asking you about Brown and Williamson's intent, Mr. Burnett. It's my understanding of your prior testimony that you concluded that the program disclosed in B and W's market analysis documents for entering the generic cigarette industry, would in your opinion, injure competition in part because it would narrow the price gap between branded and generic cigarettes and reduce the rate of growth of generics, is that correct?

A That is correct, but I would go farther in saying that what would be necessary is merely to slow the rate of growth in generics. Not necessarily to decrease the gap. All they had to do was slow down the rate of growth; not narrow the gap. If the gap would have grown to 50 percent or 70 percent, the category would have grown even faster. All they had to do was keep it from going from 40 to 45; and the predatory campaign could have still paid off.

Q Now are there documents in B and W's market analysis that you have selected and on which you rely to illustrate that point?

\* \* \*

[p. 47-197] A. . . . is Plaintiff's Exhibit 4 at Tab 4, yet again, the write-up or written description of the February overhead's presentation at Page 22, Stamp Number 095631, and it's headed, "Brown and Williamson Generic Objectives." "Year One, become a dominant factor in the generic market targeting for at least a 60 percent share of the generic market at the end of year one. Given that the company cannot be certain how quickly volume will be established, we project it - we project that volume falling into 1984 will be between three point seven and six billion sticks detailed in the financial section." And then, "Out years. Maintain dominance of the generic market, at least a 60 percent share of the generic market. Other key long-term objectives are to manage segment growth; limit potential for competitive entries by minimizing profit capability; minimize generic erosion of B and W existing business; minimize the version of B and W resources, and then human financial and manufacturing."

And then it concludes, "These objectives will be achieved while other full major margin brands are being developed for marketplace implementation." And, in the same document, turning to Page 41, Stamp Number 095650, under the heading, "Financial Generic Long-Term Pricing Strategy." "B and W's long-term pricing strategy is as follows. Manage the category growth by preventing an increase in the percentage pricing spread between generics and branded cigarettes. This [p. 47-198] will be accomplished to be one of the following tactics depending on the environment at the time of price increases. Maintain a constant percent margin difference at 40 percent between the prices." And then there's a reference to a financial schedule, which comes in later pages.



And the second point is, "Allow the percentage difference to decrease by maintaining a constant dollar spread." With again reference to a following financial table that comes later in the document. Turning the page to Page 42, it reads, "A further explanation is as follows. Schedule one maintains a generic price increase which is 60 percent of the expected increase on B and W branded cigarettes. Although this will increase the dollar spread between generics and branded, the percent difference remains constant. Consumers will not have an increased motivation to trade off image for price as has been the case with L and M not increasing their prices on generics when branded product prices increased."

Q Mr. Burnett, let me interrupt you. Can you explain how an increased dollar spread would not increase the percent spread in talking about the price difference between branded and generic cigarettes?

A Well, if I understand you correctly, you could have a difference of a dollar, between nine and ten dollars, being a ten percent reduction from the ten-dollar price. That's ten percent. If the price is then increased to twenty dollars

\* \* \*

[p. 48-32] reference, attached are the speech and support material compiled for Mr. McCarty's use at the CAC meeting."

Mr. McCarty was an executive with BATUS, BAT United States, and the CAC is the chairman's advisory

committee which is an advisory committee of BAT Industries in England, the parent company of both BATUS and Brown and Williamson.

BY MR. HOGELAND:

Q And for the record, Mr. Burnett, when did Brown and Williamson enter the generic cigarette segment?

A They began shipping product in July of 1984. They began soliciting accounts in June of 1984. This document was written in April of 1985, a little less than a year after that.

And if you turn - just turn one page to the page with the stamp number 138773, halfway down the text portion of the page Brown and Williamson wrote, "B and W's entry and pricing policies within the generic and private label segment will attempt to maximize the profit opportunity available from this market segment. B and W's goal is to improve profits from this segment through a combination of significant production cost reductions and price increases. B and W would hope to reduce the spread between generics and full price productions if we could do so without reducing its share of this segment. B and W's presence within the segment appears to have resulted in reduced consumer advertising by [p. 48-33] L and M, and a slowing in the segment's growth rate."

So after about 10 months in distribution, Brown and Williamson was writing that its presence within the segment appears to have resulted in reduced consumer advertising by L and M, and a slowing in the segment's growth rate. That statement is connected to the statement

we began with this morning that concerned entering the military section ---

MR. LONDON: Objection. I object to the witness's statement about what he thinks the document was connected with.

THE COURT: All right. Sustained.

BY MR. HOGELAND:

Q You testified earlier this morning, Mr. Burnett, about what your view as an economist was, what it would mean if a firm diverted the resources of its competitors; is that right?

A Yes, sir.

Q Now is the passage you just read consistent with your opinion as to the effect of diverting resources of a competitor?

MR. LONDON: Objection.

THE COURT: Overruled.

A Yes, it is. Brown and Williamson wrote in March that it was entering the military market to divert competitive resources from the civilian market.

[p. 48-34] The final document I selected to illustrate this point is Plaintiff's Exhibit 1374, behind - it's the last tab of this volume.

BY MR. HOGELAND:

Q Did you not select Plaintiff's Exhibit 954?

A Excuse me. I'm sorry. I missed one. It was hiding on me. The second to the last tab in this volume, Plaintiff's Exhibit 954. It is covered by a letter from Mr. Sandefur to Mr. McCarty and Frigene of BATUS on April 19, 1985, and it's, "Per your request, here's some information about the proposed generic pricing strategy as discussed in New Orleans."

And turning one page to stamp number 02697 - it may be 802697 - but the page is headed, "Generics," Brown and Williamson wrote, "B and W's pricing strategy has been to take the leadership in announcing a price increase in 1985, provided we are tracking to the 8.6 billion unit volume objective for 1985. As we are running behind our volume objectives, we are not in a position to lead a price increase, and have therefore reassessed our pricing strategy.

"It is our current belief that L and M, because of margin erosion, will initiate a price increase on the order of \$1.50 per thousand around mid-year 1985. To generate volume and improve our market presence, our position is to hold off taking a price increase for three months from the time L and M announces. Having improved our market presence [p. 48-35] during these three months, we would initiate a price increase of \$2.50 per thousand. We further anticipate that L and M, again because of margin erosion, would immediately increase their prices to parody [sic] with B and W."

And then at the very bottom of the page, the last paragraph reads, "B and W's long-term strategies in generics continued to be focused on margin improvement and to establish franchise equity through package design, et cetera."

And now to the final document I selected to illustrate this point, it is document - Plaintiff's 1374, the last tab in the book, and it is information covered by a memorandum from Mr. Bacon, who is the controller of the company, to Mr. Blott, who was the senior vice president, and several other vice presidents who were copied under the CC label, written in August of 1985. And the subject was the 1986 domestic marketing guidelines.

And turning a couple of pages to a page with the stamp number 233628, about halfway down the page, there is an underlying passage, "Generics," and the first issue under "Generics" addressed is, one, "Manage segment growth and profitability by gradually reducing percent difference between generic and full revenue brands."

That completes the documents I selected as illustrative of Brown and Williamson's statements targeting Liggett and. . . .

\* \* \*

[p. 48-65] can get the jury and have the witness come back.

All right, Mr. Belvin.

(Jury in at 11:25 a.m.)

THE COURT: All right, Mr. Burnette. If you'll come back please.

BY MR. HOGELAND:

Q Now, Mr. Burnett, in the cigarette industry in 1984 if a significant cigarette manufacturer entered the generic segment without reducing list price, with a package that looked like Liggett's, with a discriminatory volume rebate program, with a program designed to capture existing demand for generics and not create new demand for generics, and prepared to spend variable margin - as variable margin was defined by Brown and Williamson, would its conduct have, in your opinion, a reasonable possibility of injuring competition?

A Yes. It would.

Q In your opinion, would such a plan make rational business sense?

A Yes. It would.

Q Why?

A In my view, as I testified - I guess the day before and yesterday - prices charged for branded cigarettes are above competitive levels. The large branded cigarette manufacturers have monopoly level profits and prices to [p. 48-66] protect and defend.

Liggett was the price-cutter. And in an effort to protect and defend its high prices and high profits on branded cigarettes, one of the large manufacturers had an incentive to target Liggett, to go after them, and to pre-date with respect to Liggett and Myers, to slow the rate of erosion of branded cigarette sales that Liggett was imposing on all of the other manufacturers in the industry.



Q Well, would it be a key element of the business rationality of such a plan that it included a way to limit the cost of predation?

A No one ever wants to spend more than they have to to accomplish a predatory result.

Q Was [sic] the amount spent on predation or invested in predation affect the ability to recoup the investment in predation?

A Yes. It does. The smaller you have to invest to accomplish your result, the less you have to recoup. If you can accomplish your result with ten million dollars or fifteen million dollars, all you have to do in the cigarette industry is slow down the rate of loss in branded cigarettes so as to preserve or maintain the margins on branded cigarettes that would equal fifteen million dollars plus a little more.

Q Now, Mr. Burnett, in the cigarette industry in 1984, if [p. 48-67] a significant cigarette manufacturer entered the generic segment, again without reducing list price, with a package that looked like Liggett's, with a discriminatory volume based rebate program, with a program designed to capture the existing demand for generic cigarettes, not create new demand for generic cigarettes, and actually spent variable margin - as that term is defined by B & W, would such conduct, in your opinion, in fact, have injured competition?

A Yes. It would.

Q How?

A There are a couple of ways it could have achieved the objective of slowing the rate of loss or the rate of

erosion in branded sales, and I've come to think of it in two different ways; one from the perspective of the predator and one from the perspective of the firm that's being targeted - in this case Liggett.

From the perspective of the predator, it's what I call a win/win strategy. A predator targeting Liggett with matching list price and a discriminatory volume rebate schedule could have won in one of two ways.

It could have succeeded in taking a substantial chunk of the generic business and, therefore, be in a position to raise the price of generic cigarettes and narrow the price spread between branded and generic cigarettes, thereby making generic cigarettes a less attractive alternative to the [p. 48-68] consumer and probably resulting in - at least in a decrease in the rate of growth in the category if not an actual decrease in the level of generic sales.

So one way to accomplish the objective is to take control of the segment, to manage the price up and to decrease the price spread between the two types of products.

In the alternative, the other way they can accomplish the same result of narrowing the price spread, which is the other half of the win strategy, is that in entering the generic category and in making offers that go down to full variable margin, which is the manufacturing cost of making those cigarettes, they can impose very large disproportionate losses on Liggett and Myers.

Liggett was, as we all know from the testimony here, the principal and largest seller of generic cigarettes. If Liggett chose to match the low prices, Liggett was going

to eat it. Liggett was going to eat the losses. It was going to incur losses that were disproportionate to the firm that was making the price offers.

B & W lowers the price to the customers, and Liggett matches. B & W has a small – relatively small volume of sales compared to Liggett, and the losses imposed on Liggett are even greater.

So Liggett's faced with one of two options. Either they fold up their tent and go home and they give the generic [p. 48-69] segment to somebody else, in which case that somebody else – Brown and Williamson – is in a position to raise the price. Or Liggett and Myers absorbs the losses and is, in a sense, forced to raise the price themselves to reduce the cash outflows that are being imposed on them.

And I believe there's been some testimony that the cash outflows, as a result of B & W's conduct just for 1984 for matching the volume rebates, was on the order of 35 million dollars.

And Brown and Williamson recognized and knew full well that Liggett couldn't sustain or withstand that kind of attack for very long.

So from the perspective of the predator, it was win/win. Either they controlled the category and lead prices up, or they impose the losses on Liggett, in which case Liggett will raise the price because they can't continue to absorb the losses.

MR. LONDON: Move to strike everything after what Brown and Williamson recognized.

THE COURT: Overruled.

A From the perspective of Liggett, the firm that was being targeted, it was lose/lose.

Liggett's very existence in the early 1980s was predicated on the existing ---

MR. LONDON: Your Honor, is there a question [p. 48-70] pending here?

MR. HOGELAND: Yes. He's still answering a question.

MR. LONDON: Well, it was so long ago that I've lost track of it.

THE COURT: Well, he's asked him how it would have injured competition. He said --- I believe he is getting ready to answer another way in response to that question.

Go ahead.

A From the perspective of the firm that was targeted – in this case Liggett – the way the campaign was launched against them with a matching of list price and discriminatory volume rebates and a package that looked extremely similar to its own, it was lose/lose.

They could have folded their tent and gone home and just exited the generic category or significantly reduced their presence in the generic category. And since its very existence was predicated or had been predicated on generic sales, that was a very difficult thing for them to do. It would have seriously jeopardized the firm.

Their alternative, though, was to match the volume rebates in order to keep some of the volume that was

keeping their company in operation. But from their perspective that meant they had to suffer all of the losses because they had the relatively higher share.

[p. 48-71] So it's win/win on the part of the predator, and it's lose/lose on the part of Liggett and Myers.

That from my perspective as an economist is the genius of the scheme, matching list, discriminatory rebates is win/win for the predator, lose/lose for the target.

MR. LONDON: Move to strike "the genius of the scheme."

THE COURT: All right. The jury will disregard that remark. The question, of course, assumed at the beginning - the preceding question assumed if certain facts were true, and that is what he's answered.

Go ahead.

BY MR. HOGELAND:

Q Now, Mr. Burnett, would the discriminatory scheme - the discriminatory volume based scheme make such a predator better able to afford and carry out a predatory scheme?

A I believe it would.

Q Now you told us yesterday - or I guess it was Tuesday - that there were six significant cigarette manufacturers in the cigarette industry. Is that right?

A Yes.

Q Was Brown and Williamson one of them?

A Yes. Brown and Williamson has been the third largest manufacturer for some time.

Q Now, Mr. Burnett, did Brown and Williamson enter the

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[p. 48-83] A In my opinion, yes, they did.

BY MR. HOGELAND:

Q Now, Mr. Burnett, assuming that the significant - that Brown and Williamson's package looked similar to Liggett's, would that make predation more or less plausible?

A In this context it makes it more plausible.

Q You stated earlier, Mr. Burnett, that Brown and Williamson priced generic cigarettes below average variable cost. Did you study the question of whether or not Brown and Williamson actually priced below average cost for its generic cigarettes?

A Yes. I did.

Q And what did you conclude?

A I concluded that Brown and Williamson did price below variable cost from the period July 1984 through December of 1985 by almost 15 million dollars.

Q Did you cause an exhibit to be prepared setting forth that conclusion?

A Yes. I did.

Q I show you Plaintiff's Exhibit --- I show you Plaintiff's Exhibit 3066R ---



THE CLERK: Is it 39 or 30?

MR. HOGELAND: It is a nine. 3966R.

BY MR. HOGELAND:

Q And I ask you if that is the exhibit ---

\* \* \*

[p. 49-42] Q Now you've shown us your monthly columns, and we looked briefly yesterday at Plaintiff's Exhibit 3966-R. And tell us again what that is.

A That is the summary data of the price and cost or the revenue and cost calculations for the entire 18-month period from July of 1984 through December of 1985. And once again, it shows that the net revenues to Brown and Williamson after subtracting excise tax and trade and DAIP rebates was about \$71,300,000.00.

To produce - to manufacture and distribute that quantity of cigarettes over that 18-month period, Brown and Williamson laid out variable costs of \$86,275,000.00, and that put Brown and Williamson \$14,961,000.00 below their average variable costs of producing the [sic] distributing generic cigarettes.

Q And once again, Mr. Burnett, I show you Plaintiff's Exhibit 3967-R, and I ask you what that is.

A That is the same data that is presented in 3966-R, except that here I calculated a per carton rate. The average revenues after those various costs up on the top - or those various expenses of taxes and rebates, came to about \$1.42 per carton for the 18-month period. And Brown and Williamson, by my calculations, spent \$1.72 in

variable costs, and therefore priced their generic cigarettes 29.8 cents per carton below variable cost for the 18-month period.

Q Now, Mr. Burnett, I call your attention to Plaintiff's

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[p. 51-115] Q And if an economist were to tell us, and we accepted his testimony, that activity in the sale and the marketing of generic cigarettes had a downward influence on the price of branded cigarettes, then that influence would result in a gap smaller than it would have been but for that influence. Correct?

A Yes. And I would have chosen to illustrate what had happened in this industry in a completely different manner.

Q And, in fact, you told His Honor and the ladies and gentlemen of the jury here just an hour ago, didn't you, that you were firmly of the opinion that that did happen. That is to say, the effect of the generic marketing activity caused a lowering in the price of the branded product from where it would have been but for that activity.

A Absolutely. And but for the behavior of Brown and Williamson, the price of branded cigarettes would have been even lower.

Q And, in fact, you have no model, no formula, no scientific analysis that tells us exactly to what extent - strike the word "exactly" - to what extent the influence of generics has brought down the price of branded.

MR. TOPMAN: Objection, Your Honor. No foundation.

THE COURT: Overruled.

A Let me make sure I understand.

BY MR. LONDON:

\* \* \*

[p. 54-96] Correct?

A I'm sorry. It's getting kind of late. You said it's possible that ---

Q It's also true, is it not, moving from the hypothetical, that generic cigarettes are not a market as we have defined a market in our previous questions?

A It's my belief that the sale of all cigarettes is the relevant market.

Q All right, sir. And does that mean that you agree with us that generic cigarettes, that's not a market. Correct?

A Correct.

Q All right, sir. And that is for the same reasons that king size cigarettes in the hypothetical are not a market because of this thing that I've called substituteability. Right? As you put it, the consumer can demonstrate the willingness to move from one product to another.

A Yes.

Q Now indeed you have told us it is your conclusion that the price --- On the issue of substituteability,

the price of the generic cigarettes affect the desirability of that product as compared to the branded product. Correct?

A I think that's true. The greater the difference or the smaller the difference in the differential in price between branded and generic cigarettes --- Well, whichever way it goes, it will affect the number purchased of each type.

[p. 54-97] Q And for that reason and the reasons we've just discussed, a manufacturer of one segment of the cigarette market -- be it the generic segment, the filter segment, 100 millimeter segment -- cannot be said under any facts, that you know of, to have monopoly power or market power in that segment because that's not a relevant market and because their substituteability or willingness of the consumer to move over to another product. Correct?

A I think that's true, but would you please say it again? I'm not --- I view the market as the sale of cigarettes because there typically will be substitution among the different types and styles of cigarettes.

Q Therefore, it's true, is it not, that a manufacturer in one segment of the market of all cigarettes -- be that a particular price segment or style segment, whether it's 85's or 100's or black and whites or branded generics -- cannot be said to have monopoly power in that segment because that segment is in the market and he can't control supply and price.

A I think as a general matter that's true, but ---

Q All right. Now ---

A --- that's solely for purposes of market definition for merger enforcement.

Q All right.

A It doesn't necessarily tell you anything about the . . .

\* \* \*

[p. 56-139] after some period of time.

Q And what were Brown and Williamson's terms?

A I believe it was two percent, 12 or 14 days.

Q So there's a difference of one and a quarter percent?

A One and a quarter or one and a half.

Q And could you tell us what one and a quarter percent of the list price of \$18.75 was?

A Yes, just a second.

I come up with 23 cents, but somehow that doesn't seem right.

Q Well, that's what I get, too, but I think it's - my good colleague here tells me that that's a thousand - eighteen seventy-five. So that's four and a half cents a carton. Right, sir?

A That sounds better - 4.7 cents.

Q So that a customer - Okay. Let's go on.

Now do you agree, sir, that when Brown and Williamson came out at the 30-cent - the zero to 30-cent set

of brackets, that that schedule was not a predatory schedule, as you would define that?

A The net prices that would've resulted from that schedule are very, very unlikely to have put them below average variable cost.

Q So that the first offer they made was not what you as an economist would call predatory. Correct?

[p. 56-140] A It would not have resulted in their pricing below variable cost. I have a hard time separating what the original schedule was from their expressed statement that they were willing to spend a great deal more, and price below variable cost.

Q Well, I know some of these concepts are very hard for you, sir, and some of them hard for me, too, but I wish you sure would try to answer my question. And that is that you agree that the first offer that they made - the zip-to-30 offer was not as you would define "predatory" - a predatory offer. Correct?

A If that had ever been instituted and any product had ever been sold under that price schedule, it would not have put anybody below average variable cost.

Q All right, sir.

Now in your examination of the numbers in this case, what you have done and presented to the ladies and gentlemen of the jury is give us your opinion of the costs and revenues over Brown and Williamson's costs and revenues, as you've seen them, relating to the generic product over an 18-month period. And then, I think you said, you divided by 18 to get the average monthly figure. Is that right, sir?



A In one chart, I did that.

Q And in one chart you divided by 18 to get the average monthly figure. And then in another chart ---

\* \* \*

[p. 58-153] Q . . . "I want to know, sir, if you testified under oath that the cigarette industry is not a collusive oligopoly."

Answer: "That is correct.

"Now was it the truth?"

Answer: "To the best of my knowledge, yes, sir.

Question: "And did you say, sir, under oath, that the price of branded cigarettes is a combination of elements, including cost of goods, competitive environment and taxation?"

Answer: "The price of cigarettes based on the cost of manufacturing, the cost of marketing, the taxation - they all go into the price, yes. They all go into the price, yes."

Question: "And so it's nothing but a fair price, right, sir?"

Answer: "I don't really understand what you're driving at. I'm sorry, sir. What's a price or an unfair price based on the way you word it, yes, it's a fair price."

Now you've read that testimony in reaching the opinion that you have reached in this case. Is that right, sir?

A Yes, I did.

Q Now in the course of your testimony you have, on any number of occasions, have you not, used the phrase "prices above competitive levels" or "prices higher than competitive levels" or "monopoly profits," "profits above competitive levels." You've used that series of phrases a number of

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[p. 58-160] Q Okay. Now I want to direct your attention to a few other pieces of evidence and ask you some questions about it.

On July 19, 1989, Part IV, page 12, Mr. Dey was asked a question, "You described this industry, sir, as late as 1989, as a highly competitive and aggressive industry, did you not, sir?"

And the answer was, "Yes, sir, in terms of - I've expressed the competitiveness of our industry."

And were you aware, sir, that in 1989, Mr. Dey testified before the United States House of Representatives? Were you made aware of that prior to your testimony here?

A Yes.

Q And ---

A I've read it.

Q You are aware that Mr. Dey told - in 1989 - a committee of the - on Energy and Commerce at the House of Representatives - that he told the United States Congress that the cigarette industry was, quote, "a very, very highly competitive business," closed quote?

A Yes, I did read that.

Q And that on another part of his testimony before the Congress of the United States or a committee he said, "This is a highly competitive business. We fight tooth and nail."

You're aware of that?

A Yes.

[p. 58-162] Q Yes, sir. I'm sorry.

A Okay.

Q From the deposition of Mr. Dey dated March 13, 1987, page ten.

Question: "Do you agree or disagree that the major United States cigarette manufacturers, including Liggett, have reaped excessive profits from the sale of cigarettes?"

Mr. Dey said, "I disagree."

Question: "Do you agree or disagree that the major United States cigarette manufacturers have reaped monopolistic profits from the sale of cigarettes?"

Mr. Dey disagreed.

On the next page, "Do you agree or disagree that the prices of cigarettes sold by distributors have been fixed, raised, controlled, and maintained at non-competitive levels?"

Answer: "I disagree."

Question: "Do you agree or disagree that the public has been denied the benefits of free and open competition in the market place in the sale of cigarettes?"

Answer: "Read it again, please."

Question: "Do you agree or disagree that the public has been denied the benefits of free and open competition ---"

"I disagree," is the answer.

The question continues, "--- in the sale of branded cigarettes?"

[p. 58-163] Answer: "Disagree."

Page 14, question. "Do you consider that Liggett's rate of return on branded cigarette demonstrates that Liggett shares monopoly powers with other tobacco companies?"

Answer: "No."

Question of page 16: "In your opinion, Mr. Dey, does Liggett make monopoly profits on its branded cigarettes?"

Answer: "No."

Question: "In your opinion, do the other tobacco manufacturers make monopoly profits on their branded cigarettes?"

Answer: "As I define it, no."

Question: "In your opinion, does Liggett make higher than competitive profits on its branded cigarettes?"

Answer: "No."

Page 18. Question: "In your opinion, does Liggett price its branded cigarettes at higher than competitive levels?"

Answer: "No. Well, whatever - no, we don't. No."

Question: "Do you agree or disagree, Mr. Dey, that there is some form of tacit agreement with respect to branded cigarette prices among Liggett and its competitors?"

Answer: "I disagree."

Sir, did you read that testimony --- Listen to my question, please. Did you read that testimony before you

\* \* \*

[p. 58-169] THE COURT: Overruled.

A Yes, and it's important that I explain again what that means because you've now asked me the same question in about six different ways.

To me tacit coordination and tacit collusion means that the firm successfully managed to get the price above levels that would prevail under competition. We can call that a pickle, or we can call that an agreement.

It is a tacit agreement. It constitutes tacit collusion, and we could define that as a pickle if we wanted, and as long as we all understood what it meant, that prices were raised above competitive levels without the firms ever getting together and discussing it; that's what would be important.

Q All right, sir. Now I want to read to you some testimony that Mr. Grant gave in this courtroom on the

subject you and I have been discussing. And, not surprisingly, in the questioning of Mr. Grant, nobody spoke about pickles.

On July 24, 1989, Part III, page 49 --- I'll get it up on the screen so you can follow it easier. Mr. Grant testified --- Starting at the bottom, Julie, all the way down at the bottom. The last line on the page.

"Do you have any understanding with any representative of any tobacco company as to what price Liggett would charge [p. 58-170] for its branded cigarettes?"

Answer: "No, sir."

"To your knowledge, has any other officer, director, or employee of Liggett ever entered into any kind of an agreement with a representative of any other tobacco company to fix the price on branded cigarettes?"

Answer: "No, sir."

"Are you aware of any agreement between any of the other United States tobacco companies to fix the prices that are charged for branded cigarettes?"

Answer: "No, sir."

"To your knowledge, has Liggett and Myers ever been approached to join any sort of agreement to fix prices on branded cigarettes?"

Answer: "No, sir."

"Does Liggett have any understanding with any other tobacco company as to what price it would charge for its branded cigarettes?"



Answer: "No, sir."

"Do you know of any such agreement among any other manufacturers?"

Answer: "No, sir."

Question: "Does Liggett have any unwritten or unstated understandings with other tobacco manufacturers to coordinate the prices which it charges for branded cigarettes?"

[p. 58-174] "I disagree."

And on Page 52, Question: "Do you agree or disagree that cigarette manufacturers are engaged in tacit collusion to fix prices on branded products?"

Answer: "I disagree."

Now, sir, you've told us that you read that in reaching your conclusion?

A Yes, I did.

Q Now when Mr. Dey, you recognized, and Mr. Grant made those statements both in the depositions and in the trial, they were speaking under oath?

A Yes, they were.

Q And you recognized that Mr. Dey and Mr. Grant were responsible - well, Mr. Dey was president of the company in '79, '80, '81, '82, '83, '84, '85?

A Yes.

Q And the highest operating official of the company?

A Yes.

Q And Mr. Grant was the number two man in the company?

A I guess you could call him that. Mr. Turner, who runs the factory, is also an important manager of the firm. And Mr. Welsh is the chief financial officer.

Q And you are aware, are you not, sir, that Mr. Dey and Mr. Grant were personally involved in the setting of the prices at which Liggett were going to sell and did sell its branded [p. 58-175] cigarettes?

A That was one of the reasons I wanted to discuss precisely those questions and answers with them, and that's why I did discuss it with them.

Q Do you know of anybody else in the Liggett and Myers company who was there in '79, '80, '81, '82, who had more responsibility, more hands-on line responsibility for setting the prices for Liggett branded products than Mr. K. v. Day or Mr. Hal Grant?

A The only reason I'm hesitating is that I'm not sure whether or not Mr. Grant had a superior at that time. He would have been a superior entity person manager in the sales organization.

Q Well, let me ask you this question, sir. Do you know of anybody in the organization of Liggett who had any more hands-on responsibility for setting cigarette prices in the late '70s and early '80s than Mr. K. v. Dey?

A He certainly had to approve them.

Q Do you know anybody who had more responsibility than he did?

A No. He'd ultimately have to sign off on price increases.

Q He had the final word?

A Yes, he did.

MR. LONDON: I have no more questions. Thank you, sir.

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[p. 59-27] 7330, is that right?

A I've forgotten --- that one is 7330.

Q And by "that one," you mean what I've just identified as your recalculation of the generic assets; is that right?

A Yes. And the inventory chart was Plaintiff's Exhibit 7331.

Q Now, Mr. Burnett, are there other factors that make your minimum damage calculation, based on your return of assets approach, conservative?

A Yes, there are.

Q Can you identify some of those other factors for us?

A Well, again, the damage calculation cuts off in December of 1985. If there had been continuing effects or lingering effects after that, the damages would have been higher, is the key one.

Q Now you testified on cross examination that your return on asset calculated for Liggett's minimum damages was an attempt to determine what Liggett might

have earned but for B and W's anti-competitive behavior; is that correct?

A Yes.

Q Is that an accurate statement, that it determined what it would have been but for B and W's anti-competitive behavior?

A Well, it is a calculation that would reflect all forms of legal behavior or legal competition, so that it reflects and takes into account the potential effects on Liggett of, for [p. 59-28] example, Doral and the other low-priced cigarettes that were introduced at about that time.

Q And, Mr. Burnett, in fact, you testified that Liggett lost money on its generic cigarettes during that period, did you not?

A Yes, they did.

Q And did you take that into account in calculating the minimum Liggett damages for purposes of your return on assets calculation?

A No. I did. I basically started it at zero, and had I reflected the fact that they had actually lost money on their generic enterprise, the damages would have been, again, yet higher.

Q Now, Mr. Burnett, you also testified both on direct examination and then again on cross examination that the 89.6-million-dollar measure of Liggett's damage based on rebates constituted what you called an upper bound; is that correct?

A Yes.

Q And you testified that that 89.6 million was a conservative calculation of Liggett's damages; is that correct?

A I believe so. It left out a great deal of the competitive response to, for example, Doral.

Q And you also are aware, are you not, that Liggett and

\* \* \*

[p. 59-72] Q And you relied on that testimony and that data. Is that correct?

A Yes. I did.

Q Now, Mr. Burnett, you did conclude, did you not, that one of the effects of Brown and Williamson's entry into the generic cigarette business was to divert Liggett's resources from advertising generic cigarettes. Is that right?

A Yes.

Q And you relied on that conclusion, in part, for your opinion that Brown and Williamson's conduct had injured competition. Is that correct?

A Yes.

Q I show you, Mr. Burnett, Plaintiff's Exhibit 20 which is in evidence.

MR. HOGELAND: And I'll ask Denise to pass up copies of Plaintiff's Exhibit 20 to the jury.

BY MR. HOGELAND:

Q Now, Mr. Burnett, did you rely on any Brown and Williamson documents for your conclusion that Brown and Williamson's entry into the generic cigarette business had resulted in a reduction of Liggett's consumer advertising?

A Yes.

Q I call your attention --- Let me first of all ask you, what is Plaintiff's Exhibit 20?

A This is a memorandum from Ms. Trina Olges to a number of [p. 59-73] the senior executives of Brown and Williamson in April of 1985. And it reads on the front page, "For your reference, attached are the speech and support material compiled for Mr. McCarty's use at the CAC meeting." Mr. McCarty was a senior officer, executive at BATUS or B & W's parent.

Q And you read testimony here that the CAC meeting was the chairman's advisory committee meeting. Is that right?

A Correct.

Q Of British American Tobacco. Is that right?

A Of BAT in England.

Q Now I call your attention to Page 138773 of Plaintiff's Exhibit 20. And I will ask you to read the last sentence in the next to the last paragraph of Plaintiff's Exhibit 20 on that page.

A Yes. Let me make sure I've got the right passage. It's the first bullet, the first indented paragraph.



And the last sentence reads, "B & W's presence within the segment appears to have resulted in reduced consumer advertising by L & M and a slowing in the segment's growth rate."

Q And when was that statement written, Mr. Burnett?

A April of 1985.

Q And that was how long after Brown and Williamson had established a presence within the segment?

A Nine or ten months.

[p. 59-74] Q Now you agreed - you came to the same conclusion that is stated there on Plaintiff's Exhibit 20, did you not, Mr. Burnett?

MR. LONDON: Objection.

THE COURT: Sustained. Your witness.

BY MR. HOGELAND:

Q Now, Mr. Burnett, you recall during your cross examination that Mr. London asked questions on several different days about the subject of whether or not rebates paid to the direct buying customers are passed through to consumers?

A Yes.

Q Now in your opinion, and based on your analysis and study of this industry, Mr. Burnett, did the rebates paid by B & W and by Liggett and by Reynolds, with respect to Doral, get passed through into the price consumers paid at retail?

A As a general matter, they did not. A very small amount of them may have been passed through, but as a general matter, the price at retail is a function of the list price and does not reflect the rebates.

Q All right. Mr. Burnett, I would show you ---

MR. HOGELAND: --- and I would ask Denise to pass out to the jury copies of Plaintiff's Exhibit 4269.

BY MR. HOGELAND:

Q Now I ask you, Mr. Burnett, to tell us what Plaintiff's [p. 59-75] Exhibit 4269 is.

A This is a memorandum for Mr. Christensen - although the name isn't very legible here - to Mr. Blott with copies to some of the other members of the sales organization of Brown and Williamson, authored in February 1985.

And it discusses or assesses on the second page the relationship as measured by Mr. Christensen between the list price for both branded and full revenue - I'm sorry - full revenue and generic cigarettes, and the ultimate consumer cost per carton. That's the price the consumer pays.

Q Well, going back to the first page, it says, "The attached analysis compares what has happened to retail carton and pack prices," does it not?

A Yes. It does.

Q Now did Mr. Christensen, when he calculated retail price of generic cigarettes, did he pass through any rebates to the retailer?

MR. LONDON: Objection as to what he did.

THE COURT: Well, what the figures show. If that's the question, you may answer.

A What the data shows is that consistent with the earlier years, there were no rebates passed through. In the calculation performed by Mr. Christensen, the computation begins with the list price of branded and generic cigarettes, and performs a series of computations adding state taxes and [p. 59-76] wholesaler markups and retailer markups to estimate the cost to the consumer or the retail price.

And what one notices is that going from 1983, when there were no rebates, to 1984 – or actually in 1984, in January, there were no rebates. In January of 1985, when there were rebates, this analysis essentially assumes that no rebates are passed on to the consumer.

There are no rebates reflected here anywhere in deriving the consumer cost per carton or per pack.

Q Now this analysis uses average state taxes, does it not?

A Yes. It does.

Q And do they change over time?

A Yes. Mr. Christensen has them in here as increasing from a dollar ten per thousand in January of 1980 increasing gradually to a dollar twenty per thousand in January of 1985.

Q And this analysis also uses standardized wholesaler and retailer markups, does it not?

A Yes. It does. It assumes that the markup at wholesale is 7 percent and that the markup at retail is 11 percent.

Q And then Mr. Christensen points out that you should use this for directional advice only, does he not?

a Yes. He does.

Q And he states, does he not, that the results vary greatly depending on state taxes and customer markup policies. Is that right?

[p. 59-77] A Yes. He does.

Q And there's no reference about results varying because of rebates. Is that right?

A No. There is not.

Q And as you pointed out earlier, there were periods of time covered by this analysis where rebates were in effect and periods where they were not. Is that correct?

A Yes. The principal comparison would be January '83 and January '84 to January '85 when there were substantial rebates in effect for generic cigarettes.

Q And just while we're on this document at this time, Mr. Burnett, can you read the last line which shows – sorry – the third from the last line – which shows the difference per carton as a percent of full revenue cigarettes?

A Yes. And if we look, it's really three calculations up from the bottom. It says, "Difference per carton as a percent of full revenue."

Reading across from 1980 through 1985, the percent difference is 30.1 percent in 1980, 26.4 percent in 1981, 30.4 percent in '82, 29.6 in January of '83, 34.1 percent in January of '84, and 33.3 percent, I believe, in January of 1985.

Q Now, Mr. Burnett, I show you what is in evidence as Plaintiff's Exhibit Number 7.

MR. HOGELAND: And I will ask Ms. Coleman to pass

\* \* \*

(The document above  
(referred to was marked  
(for identification as:

(PLAINTIFF'S EXHIBIT  
(NUMBER 7335.

[p. 59-117] Q Now I show you once again Plaintiff's Exhibit 4298. Does that show what the increase in king size branded cigarettes was in June of 1989?

A Yes. Between January and June of 1989, the list price of the king cartons or the kings per thousand went up by another \$2.50. If we annualize that and just hypothesize, not assert, but hypothesize that it increased by another \$2.50 this December, the increase this year would have been \$5.00.

Q And that would be at an annual rate of \$5.00, going up \$2.50 from January to June. Is that right?

A Yes, it would.

Q Now, Mr. Burnett, yesterday Mr. London read you a lot of testimony from Mr. Dey and Mr. Grant here in this trial and then also from their depositions. Do you recall that?

A Yes, I do. It was at the end of yesterday.

Q Now you previously testified that in your opinion the firms in this industry may be able to tacitly coordinate their behavior and approximate the result of a monopolist. Is that right?

A Yes.

[p. 59-118] Q Now Mr. London asked you questions about your opinion that there is this tacit collusion in the cigarette industry. And he asked you whether you took Mr. Dey's and Mr. Grant's testimony and deposition testimony into account in reaching your full conclusion. Is that right?

A Yes.

Q And you offered to explain how you had, but he didn't ask you. And I'm asking you now. How have you taken that into account when reaching your conclusion?

A Well, I read those depositions with some care. And I took it into account in the following way. It is typical. It's usual for economists and businessmen to use words in somewhat different fashion.

With respect to the passages that were read from Mr. Dey and Mr. Grant, the differences in the way an economist views things and the way a businessman talks about things can be broken down into, I guess, three general categories.



The first has to do with the interpretation of profitability and whether prices and profits are, in a sense, as I use it, for both competitive levels or not. And businessmen and economists frequently don't understand those terms and those concepts in quite the same way.

Further, when you talk to a businessman about tacit collusion or agreement, even if you say the word "tacit," they tend to think that you mean overt collusion which is a [p. 59-119] criminal offense. You can't get together in a hotel room ---

MR. LONDON: Your Honor, I object this speculation about what other people may think.

THE COURT: All right. Sustained to that part.

A There's a misunderstanding. There's a failure to essentially meet without ---

MR. LONDON: I object to this testimony about specific or a general effort to psychoanalyze the rest of the business community about what they think, Your Honor.

THE COURT: All right. If you're explaining why you did not consider Dey and Grant's testimony in a particular way ---

Is that the question, Mr. Hogeland?

MR. HOGELAND: That is the question, Your Honor.

THE COURT: All right. But businessmen generally - I mean, if you're testifying that you didn't think they knew what they were talking about or understood the terms, you may testify to that effect.

A That's essentially the point. Economists and businessmen tend to use those terms and those concepts differently. And unless you discuss something specifically back and forth and explain to the businessman what it is you mean by those phrases and by those terms, there is frequently misunderstanding.

That's something that I have experienced in almost the [p. 59-120] last fifteen years in doing this kind of work, that when you talk to a businessman, if you use technical, economic terms, you have to explain what you mean. Otherwise, it's like ships passing in the night.

And it's my belief that that's what was occurring with respect to the testimony of Mr. Dey and Mr. Grant. They don't use those words in the same way an economist does. Indeed, I discussed those concepts and those terms subsequently with Mr. Dey and Mr. Grant and we have a meeting of the minds.

MR. LONDON: Objection to this.

THE COURT: All right. Sustained to the subsequent discussions.

BY MR. HOGELAND:

Q Now, Mr. Burnett, I show you what I've marked as Plaintiff's Exhibit 7316, for identification ---

(The document above  
(referred to was marked  
(for identification as:

(PLAINTIFF'S EXHIBIT  
NUMBER 7316.

BY MR. HOGELAND:

Q --- 7315, and I ask you, if you can tell me what they are.

\* \* \*

[p. 59-128] BY MR. HOGELAND:

Q Mr. Burnett, is what you have just testified, about the different use of terms by economists and businessmen, something that is recognized by accepted economic authority?

A Yes, it is. It is recognized by anybody who does any work like this for any period of time and really ever carries out a substantive [sic] interview with a business executive. And it is recognized in the economic literature as well.

Q Now on your cross examination Mr. London read to you from a book by -- what I believe you called Professor Dr. Mike Scherer; is that right?

A Professor Scherer; yes.

Q And is there anything on this subject in Professor Scherer's *Industrial Market Structure and Economic Performance*, which I've just handed you?

A That bears on this issue?

Q That bears on this issue -- anything on this subject?

A Yes, there is.

MR. HOGELAND: I mark this as Plaintiff's Exhibit 5333.

(The document above  
(referred to was marked  
(for identification as:

(PLAINTIFF'S EXHIBIT  
(NUMBER 5333.

Q Can you tell us what is in Plaintiff's Exhibit 5333 [p. 59-129] on this subject?

A Yes. In the second chapter of the book titled, "The Welfare Economics of Competition and Monopoly," there is a passage that refers specifically to this issue. Professor Scherer in the beginning [sic] of the chapter is discussing the economist's concept of competition. And on page ten in the second column he writes, "This technical definition of competition differs markedly from the usage adopted by business people who, following Adam Smith's lead, are apt to perceive competition as a conscious [sic] striving against other firms for patronage, perhaps on a price basis, but possibly also or alternatively on nonpriced grounds. Failure to recognize these implied semantic distinctions has often led to confusion in policy discussions. To keep such confusion at a minimum, we adopt the term 'rivalry' to characterize much of the activity business people commonly call competition."

I think that captures it. Professor Scherer is recognizing the difference in the way businessmen and economists tend to use technical terms such as competition.

Competition to an economist has implications that bear on such things as the number of firms competing in the market, the structure of the market, the conditions of entry into the market. Whereas, when you use the word

"competition" with a businessman, they typically will turn their mind immediately [p. 59-130] to things such as advertising and new product introductions.

Those are, of course, things economists take into account, and indeed I have here. The only point is that when you talk to somebody you've both got to be on the same wave length; you've got to be on the same page. In this case it would have been on page ten, so that we understood the distinction between the economist's use of competition and the businessman's.

But unless you understand the potential distinctions, there is the possibility of confusion and mischief.

Q Mr. Burnett, as an industrial organization economist, based on your study and analysis of the cigarette industry, have you concluded that branded cigarette prices are above competitive levels?

A Yes, I have.

Q And based on your study and analysis of the cigarette industry, have you concluded or inferred that overt or explicit collusion or greed or conspiracy exists among any of the cigarette manufacturers, with respect to cigarette prices?

A No, I have not. I have seen no evidence of overt or explicit conspiracy.

Q Now, Mr. Burnett, a week ago Mr. London asked you on cross-examination some questions about Reynolds - R.J. Reynolds Tobacco Company's entry into the low price

\* \* \*

[p. 60-127] A . . . volume accounts.

"Further, L & M may spend down to full variable margin, i.e., zero profit. Conservatively accepting that generics will attain about 24 billion units in 1984, of which L & M might secure 20 billion. It would cost L & M an additional 35 to 45 million dollars in lost variable margin to defend its business. Assuming a competitor entered in June and Liggett defended in the third and fourth quarter, first by matching and then by going to a zero profit position."

Q Now, Mr. Burnett, did you - have you previously in your direct examination read that paragraph to the jury?

A Yes, I did.

Q And did you take that paragraph into account in reaching the conclusions that you expressed in your examination?

A Yes, I did.

Q In what way?

A Well, the statements about spending or "It would cost L & M an additional 35 to 45 million dollars just in the last six months of 1984 to defend its generic business." is half of the win/win-lose/lose strategy. Liggett had the option either of defending the generic business, in which case they would lose a heck of a lot of money --- Indeed, this is 35 to 45 million dollars just in the last six months.



Recognizing that they could not sustain those losses, Liggett would have its resources diverted and would be [p. 60-128] harmed. Liggett's alternative was to give up the game and to cede control of the category to Brown and Williamson, in which case Brown and Williamson would be in a position to raise generic prices and narrow the gap and decrease the sale of generic cigarettes.

So this 35 to 45 million dollars is one-half of the win/win strategy. Either Liggett gives up and gives control of the category to B & W, or Liggett tries to defend its position in the category and sustain its very, very large losses until it is no longer in a position to continue sustaining them. In which case, they give up the game anyway. So this paragraph really reflects one-half of the win/win strategy. From Liggett's perspective it's a lose/lose strategy.

Either they defend and lose a lot of money, or they give up the game and go home, in which case they are harmed because they lose the generic volume and the generic business.

MR. HOGELAND: I have no further questions, Your Honor.

THE COURT: All right. Anything as a result of this additional questioning, Mr. London?

#### RECROSS EXAMINATION

BY MR. LONDON:

Q As a matter of economic theory, did Brown and Williamson

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#### [Excerpt Of The Trial Testimony Of B. Bacon]

[p. 61-172] Mr. Bacon, you prepared January, 1986?"

A "If that's the date that's on there."

Q "And you concluded in this document that Brown and Williamson, for the year 1985, lost a trading profit of 1.6 million dollars on generics?"

A "If that's what the schedule indicates."

Q "It says that, doesn't it?"

A "That's what it indicates, yes."

Q "For the period July through December, 1984, you concluded, did you not, that Brown and Williamson lost money on its generics in the amount of \$400,000.00?"

A "That's what the schedule shows."

Q "And you prepared the schedule?"

A "I did."

Q "And did you also conclude that for the period July, 1984, to December 31st, 1985, that Brown and Williamson lost two million dollars on its generic cigarettes?"

A "That's what the schedule shows."

Q "And you prepared the schedule, correct, sir?"

A "That is correct."

Q "Are you familiar with the phrase 'low-price cigarettes'?"

A "I am."

Q "What does it mean to you, sir?"

Q "It means pricing below what I call full revenue

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[Excerpt Of The Trial Testimony Of K. Elzinga]

[p. 61-212] A "Kenneth Gerald Elzinga."

Q "Just because a business strategy is motivated from a desire to make money, doesn't mean that a business strategy is nonpredatory, does it?"

A "May I have that one again."

Q "Just because a business strategy is motivated from a desire to make money, doesn't mean that a business strategy is nonpredatory, does it?"

A "No, of course not. A predatory strategy is designed to make money."

Q "Must a victim of the predatory pricing be driven out of business for there to be predation?"

A "No."

Q "Do you agree that predation could be successful if the targeted competitor reduced its competitive efforts in response to a predatory price?"

A "By reduce its efforts, do you mean reduce its presence in the market, cut back on output, raise price, that sort of thing?"

Q "Yes."

A "Then I think my answer is yes, if yes means predation could be successful."

Q "Does the term 'oligopolistic market' mean anything to you?"

A "Yes."

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**[Excerpt of the Trial Testimony of D. Mills]**

[p. 61-216] whether B&W priced its generic cigarettes above average variable cost, what is your answer?"

A "Insofar as by 'priced' you are only looking at the direct sales revenue on generic cigarettes, and are excluding, for instance, tax benefits, other financial benefits that the company enjoyed by producing generic cigarettes, the issue is different."

Q "Did B&W price above or below average variable cost in 1984 and 1985?"

A "Pretax trading profit was negative. Therefore, if you disregard financial consequences other than direct sales revenues in what you refer to as price, the answer would be that prices are below average variable cost."

Q "Do you consider the cigarette industry to be an oligopolistic industry?"

"Now?"

A "Yes."

Q "Do you believe there is tacit collusion in the cigarette industry?"

A "I would like for you to define what you think it means."

Q "Have you ever used the term?"

A "I am very careful not to ordinarily. It confuses my students."

Q "Has there been any type of collusion in the cigarette industry, in your opinion?"

[p. 61-217] At which point Mr. Peck asked, "Are you talking about now?" And I said "yes".

A "I am not aware of any collusive activity in the cigarette industry at present."

Q "What type of structures in industry indicate that collusion might be more likely than not?"

A "Other things the same, I think a collusion is more likely to occur and survive with few firms."

Q "Is collusion more likely in a highly concentrated industry?"

At which point Mr. Peck asked, "What do you mean by highly concentrated?" And I said, "Herfinahl index of more than 2,000."

A "Other things equal, for industries that are very highly concentrated, collusion is more likely than for industries that have very little concentration."

Q "Do you consider the cigarette industry to be highly concentrated?"

A "It's a very concentrated industry."

Q "Does 'barriers to entry' mean anything to you?"

A "Yes, it does. Two things. They are distinct categories."

Q "What are they?"

A "Sometimes entry barriers are referred to as any financial obstacle to entry that an entrant must incur. At [p. 61-218] other times, entry barriers are referred to as



any obstacle that an entrant must incur than an incumbent firm either does not or has not in the past had to incur."

Q "Do you believe that there are high barriers to entry in the cigarette industry under either of those definitions?"

A "Entry to the production of cigarettes?"

Q "Yes."

A "By a firm not currently producing cigarettes?"

Q "Correct"

A "I think that by the definition that any financial outlay is an entry barrier, that entry barriers for a firm outside the cigarette industry are relatively high."

Q "What about the second definition? Aren't they even higher in the second definition?"

MR. LEFELL: Can you read that again.

MR. RASMUSSEN: Yes.

Q "What about the second definition? Aren't they high even under the second definition?"

A "I don't believe they are."

Q "Why not?"

A "I don't believe there are costs associated with producing and marketing cigarettes that a potential entrant would have to incur that existing firms do not incur or have not in the past incurred."

Q "In trying to determine whether there are above [p. 61-219] competitive - whether there are price levels

above the competitive price levels in an industry, is the structure of the industry relevant?"

A "Yes."

Q "And is the concentration of the industry relevant?"

A "As an element of structure, yes."

Q "And is the existence of entry barriers relevant?"

A "Entry conditions are relevant."

Q "Are prices above the competitive level more likely to occur in a highly concentrated industry than an unconcentrated industry?"

A "Other things equal, looking at a very large sample of industries and a great disparity in the level of concentration in the two in your hypothetical, yes."

Q "And all other things equal, are above competitive level prices more likely to occur in an industry where high --- "Let me start again." All other things being equal, are above competitive level prices more likely to occur in an industry with high entry barriers than one with low entry barriers?"

A "Yes, for the definition of entry barriers that encompasses only those costs which an entrant must bear, but which an incumbent firm does not have to bear or has not in the past borne."

Q "If you saw an industry that had high concentration and comparatively high accounting rates of return, would the fact [p. 61-220] of the comparatively high

accounting rates of return be an indicator of possible pricing above the competitive level?"

A "Not necessarily."

Q "Would it be a relevant factor?"

A "Yes. It would arouse my curiosity."

Q "What pricing practices would you look for in trying to determine whether there might be prices above competitive levels?"

A "I think it's very difficult for an economist or an accountant or any other objective observer to look at a market in particular and to judge whether prices are above or below the competitive level."

Q "Would you compare accounting rates of return ---"

MR. PECK: Garrett, could I have a page?

MR. RASMUSSEN: Excuse me; I'm on Page 75.

MR. PECK: Thank you, Garrett.

MR. RASMUSSEN: Let me start again.

Q "What pricing practices would you look for in trying to determine whether there might be prices above a competitive level?"

A "I think it's very difficult for an economist or an accountant or any other objective observer to look at a market in particular and to judge whether prices are above or below the competitive level."

Q "Would you compare accounting rates of return in one [p. 61-221] industry with accounting rates of return in another industry, then?"

A "I might do that with extreme care."

Q "What else could you do?"

A "As I said before, you can look at conduct, and you can look at structure."

Q "All right. With respect to conduct, what can you look for? You said pricing practices, but when we poke into that, you said you really can't look into pricing practices because ---"

A "Evidence of overt collusion."

Q "What is evidence of overt collusion?"

A "Transcripts of telephone calls, minutes of meetings."

Q "Can there be prices higher than competitive level prices absent overt collusion?"

A "In what kind of industry?"

Q "In a highly concentrated industry."

A "Probably."

Q "What type of pricing behavior would you look to in that highly concentrated industry to see or to test the hypothesis that there might be pricing above competitive levels?"

A "It is suggestive, if there is a dominant firm, a firm with a market share far above any of its rivals, that happens to lead ---"

MR. LEFELL: Ken, you left out a word.

\* \* \*

[p. 61-223] disciplining or removing rivals and, as an ancillary effect, discouraging new entrants?"

A "Pricing below marginal cost to do ---"

Q "For the purpose of disciplining or removing rivals and, as an ancillary effect, discouraging new entrants?"

A "I think that's a very adequate definition."

Q "Predation doesn't have to result in a competitor leaving the market, does it?"

A "For it to be predation?"

Q "Yes."

A "I would say not."

Q "Predation could be successful if the predator reduced its competitive efforts; isn't that correct?"

A "Say it again, please."

Q "Predation could be successful if the competitor, who is the victim of the predation, reduced its competitive efforts; isn't that correct?"

A "If the victim is a competitor, and if the victim is engaging in competitive behavior, and if the nature of predation is to get the competitor to cease acting in that manner, yes."

Q "Do you agree that any realistic theory of predation recognizes that the predator, as well as his victims ---"

MR. PECK: What page are you on, Garrett?

MR. RASMUSSEN: On Page 95, I'll start again.

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[p. 61-226] Q "No, assuming that B&W, for some reason, believed that it could sell generic cigarettes in such a way as to contain the growth of all generic cigarettes in the long run, would that be an anticompetitive intention?"

A "How do you envision them doing that?"

Q "Assume they can do it, anticompetitive intention. We are talking about intention, not conduct now."

A "I might want to think about this one some more, but it seems to me now that insofar as the sole intention of a firm in entering a line of business like that, is to somehow destroy it, that the intention to do that is anticompetitive."

Q "Excuse me, it's late in the day. Good thing I am not an economist." I mixed up a few questions at that point.

"Assuming that demand was declining in the period 1980 to the end of 1985, costs were stationary and list prices were being increased, would that be suggestive of collusion?"

A "Among the cigarette manufacturers?"

Q "Yes."

A "Price fixing could be an explanation for that."

Q "What about - what else could be an explanation for it?"



A "You have said, have you not, that we are looking at the before excise tax of cigarettes, or is it okay for us to assume that excise taxes are constant?"

Q "Yes, assuming excise taxes are constant."

[p. 61-227] A "I cannot think of an explanation for that hypothetical that accords with the theory of competition. We are assuming that products remain the same as before, no changes in the products."

Q "Yes. Could that behavior reflect price leadership in an oligopolistic market?"

A "That's really two questions. I would infer it's an oligopolistic market just from the fact, the mere facts of the level of concentration and other structural levels."

Q "Would that pricing behavior suggest cooperative pricing among the firms absent an express collusive agreement?"

A "As opposed to there being an explicit collusive agreement?"

Q "Yes"

A "I would think any collusive agreement that is effective, whether explicit or tacit, could produce the scenario you have described."

Q "Assume that Liggett - well, assume that Liggett wrote a document saying that its intention was to dominate the generic category. Would that be anticompetitive?"

A "Once again, the document only goes to the intent of Liggett, and whether Liggett engaged in some

anticompetitive practice is not revealed by the intent recorded in the document."

Q "What if the document said that it was Liggett's intent

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[p. 61-231] Q "But prior to Liggett's introduction of generic cigarettes, prior to 1980, isn't it true that price had seldom been a competitive tool in the cigarette industry?"

A "By which you mean there was not a great deal of active price competition?"

Q "Yes"

A "That's the opinion of economists who have studied the industry carefully, and I am not prepared, having not studied the industry that carefully, myself, to disagree."

Q "If B&W's consortium were truly available to everyone, wouldn't you expect all customers to be in the top volume bracket?"

A "If they were available to everyone, literally, and without any transactions costs, search costs, lack of information about the full availability of those terms and the like, then yes."

Q "Did you see a B&W document that gave any explanation for why B&W promulgated volume rebate schedules?"

A "I do recall testimony to the effect that Brown & Williamson sought to sell to large customers, and I would

infer that the volume breaks were drawn up to give incentives to this category of customers."

Q "Isn't it true that B&W did sell generic cigarettes to different customers at different prices during 1984?"

A "At different net prices?"

[p. 61-232] Q "Yes"

A "That is rebates included. My understanding is yes."

Q "Was another objective trying to brake, b-r-a-k-e, as much as possible, the growth of the generic segment at the same time they were pushing the accelerator to get into the generic segment?"

And Mr. Peck objected to the form of my question.

A "I had difficulty all along with this idea of going both at once. It seems to me that having entered the segment, that is a vote for involvement in the segment, active involvement in the segment, and that it's inconsistent with a notion that they were trying to somehow thwart the sale of generic cigarettes."

Q "Didn't you see some documents that - written by senior B&W executives, that used about - a desire not to or a constraint of not expanding the generic category?"

A "I recall that being raised as a concern at some point. I also recall at least in a couple of places, in documents, one in March and one I believe in May of '84, that that seemed to be - I think I can quote this - no longer tenable. That is, the company was in no position, after R.J. Reynolds repositioned Doral, to compete with

black and white cigarettes, to in any sense control the segment."

Q "Didn't Jan Tharaldson, a B&W employee, also tell you in the fall of 1985 if you could come up with a method by which

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**[Excerpt Of The Trial Testimony Of T. Keller]**

[p. 62-44] didn't, necessarily, I don't think. At least, their initial offer wasn't. Now maybe there are some documents in there that said before they even made the first offer - I can't recall - they may have said that "We are prepared to spend down to zero variable margin," or something. But this is a little too general.

MR. TOPMAN: Okay, sir.

(End of bench conference.)

BY MR. TOPMAN:

Q Sir, is there a relationship between spending full variable margin or spending variable margin fully on trade discounts and allowances, and pricing below average variable cost?

MR. LONDON: Objection to the form of that question.

A Yes, there is.

THE COURT: Repeat the question. Is there a relationship between - and what was the first word, "full"?

MR. TOPMAN: Spending variable margin on trade discounts and allowances, and pricing below average variable cost.

THE COURT: Spending any amount of variable margin?

MR. TOPMAN: Spending --- Yes.

THE COURT: All right, sir. Overruled. If you can answer - you may answer if you can answer it in that form.

A The answer to the question is yes.

[p. 62-45] BY MR. TOPMAN:

Q Can you tell us what that relationship is?

A Well, if you spend full variable margin on the total of the variable margin, you will not have covered certain variable costs. Therefore, you will, in fact, be selling the product at less than the full variable cost or the average variable cost on a per-unit basis.

Q Okay. And can you give us some examples of variable cost that would not be covered if you spent the variable margin in full on trade discounts and allowances?

A Well, you would not be covering variable overhead. You would not be covering the carrying costs. You would not be covering any selling costs, because there are no selling costs associated with that variable margin.

Q Have you had an exhibit prepared to illustrate and demonstrate your testimony that spending full variable margin on trade discounts and allowances is pricing below average variable cost?

A Yes.

Q I show you Plaintiff's Exhibit 7314, which is a chart you have prepared to assist you, sir, in illustrating that?

A Yes, sir.



Q Would you come up, Dean Keller, if you would, and using PX-7314, explain and illustrate what you've just testified about, sir?

[p. 62-46] A Yes, sir. This is a chart which is labeled, "The effect of spending full variable margin on trade discounts and allowances."

It shows that the variable costs exceed the sales value. And what we have here in this green area is represented by the total revenue derived from the sale of the product. It's labeled, "Sales value," which says this is the total dollars received from customers for the sale of the product during a particular period of time. In fact, we spend a portion of those dollars on the variable manufacturing costs and excise taxes associated with the manufacturing of that product.

We will have what is left, called the variable margin or the full variable margin. That's the remainder of the revenue after deducting from revenue the cost of manufacturing the product and paying the excise tax to the federal government.

At that point in time, we have other variable costs in the form of manufacturing overhead costs that we referred to. And we have carrying costs of the working capital that we have referred to, that must be covered. And, of course, that comes out of, if you will, the variable margin - full variable margin. And that, of course, leaves some additional margin which essentially is available to be used to cover other costs or could be used for discounts and allowances. But at that point these variable

costs are being covered as [p. 62-47] well as the manufacturing costs, and there's some money left over, if you will.

If, in fact, we spend this variable margin in trade discounts and allowances, which essentially is typically thought of as a reduction of the selling price, and we're covering our variable costs, but there's nothing else left over, that's all that we have available to us. If at that point we spend additional money on discounts and allowances, and we, of course, will not be covering certain costs, and the costs - the variable costs we will not be covering are the carrying costs of working capital, because we have increased the trade discounts and allowances. and these are the variable costs in excess of sales value which are not covered.

And then, finally, if we discount the product further with additional trade discounts and allowances, we will also not be covering the variable manufacturing overhead. So if we spend the entire variable margin on trade discounts and allowances, we will, in fact, not be covering these carrying costs or the variable manufacturing costs, at least. So these costs are variable costs in excess of the total sales value, which is the total revenue derived from the sale of our product to our customers.

Q Thank you, Dean Keller.

Now these two items on this illustration, for example, [p. 62-48] would be the amount by which you would be pricing below average variable cost?

A That is correct.

Q Dean Keller, do the B and W planning documents prepared in connection with Brown and Williamson's introduction of generics state that B and W was prepared to spend full variable margin on trade discounts and allowances?

A Yes.

Q Do you have an opinion whether, as an accounting financial matter, this is equivalent to stating that Brown and Williamson is prepared to sell below average variable cost?

MR. LONDON: Object, Your Honor.

THE COURT: Overruled.

A Yes, sir.

BY MR. TOPMAN:

Q Now, sir, I'd like to show you Plaintiff's Exhibit 2, which is in Tab 5. Do you have that, sir?

A Yes, I do.

Q And it's entitled what, sir?

A It's entitled, "Generics presentation," and it's dated February 9, 1984.

Q And would you turn to the page stamped 068425?

A Yes, sir.

Q And what is it headed, sir?

\* \* \*

[p. 64-52] this question first, Your Honor.

MR. FOSTER: That's the reason I want to approach. I object.

THE COURT: Well, what is the objection? I'm going to overrule any objection to the question.

MR. FOSTER: The objection, Your Honor ---

THE COURT: No, sir. I'm going to overrule the objection to the question. Go ahead.

A Sir, I don't know how to answer your question except to say that prices were charged were competitive prices [sic]. They were prices that sold the product in the marketplace, and therefore were market-determined prices.

BY MR. LONDON:

Q Does that mean that they weren't higher than competitive prices?

A They were market-determined prices. And I don't know what the concept of competitive prices is that you have in mind, or I don't have one in mind. So I can't answer the question they were or they were not.

Q Well, sir, you've told us now that you were - you have a degree - you majored in economics in college, and you are in the economics department at Duke; isn't that right? You were an associate professor in the Department of Economics; isn't that right?

A I taught accounting. It was a combined department of [p. 64-53] accounting, economics, and business administration.

Q And is it your --- Well, let me ask another question. Was the company of which you were a director making higher than competitive profits on its branded products while you were there?

MR. FOSTER: Objection, Your Honor. That's what he just said he can't answer.

THE COURT: Well, if you can answer, you may. You say you don't know?

THE WITNESS: I don't know.

BY MR. LONDON:

Q Well, did you -- as a director and as somebody who is aware, you knew, did you not, that Liggett was charging pretty much the same for its cigarette products as were its competitors? You knew that?

MR. TOPMAN: Objection. Beyond the scope. It's fact testimony.

THE COURT: Overruled.

A I don't know what the competitors or Liggett was charging. I know what the list price to the customer was in the store, but I determined that as a consumer, not as a director.

BY MR. LONDON:

Q Were you aware in 1978, '79, and '80 of any information that Liggett was tacitly coordinating its list prices with [p. 64-54] another company?

A No, sir.

MR. TOPMAN: Your Honor, I would like a continuing objection to this line.

THE COURT: Yes, sir. Go ahead.

BY MR. LONDON:

Q Were you aware of any information that Liggett was engaged in any sort of tacit, unspoken or unstated, understanding of any kind with the other tobacco companies respecting the prices of its products?

A If it was unstated or unspoken of any kind, I wouldn't have any way to know it, sir. So, no, I didn't know anything about it.

Q Is it fair to say, sir, that while you sat on the board of directors of Liggett and Myers ---

MR. TOPMAN: Objection.

THE COURT: To what?

MR. TOPMAN: The question, Your Honor.

THE COURT: Well, he hasn't finished it.

MR. TOPMAN: Well, he said he was director of Liggett and Myers. The testimony is directly to the contrary.

THE COURT: Liggett Group.

BY MR. LONDON:

Q When you were on the board of Liggett --- Withdrawn. I

\* \* \*



**[Excerpt Of The Trial Testimony Of L. Butler]**

[p. 69-178] Q All right, sir. Let me ask you to look at the attachment to that letter for me, please, sir.

Does it say here, sir, as a part of that attachment, "Ask B&W for a two year guarantee on their hot-shot deals. Wouldn't you get some strange answers"?

A That's what it says, yes, sir.

Q All right, sir. And is that letter dated prior to the time that you guaranteed your rebates for a year, sir?

A Yes, sir.

Q Did you receive word from the field, sir, that those types of comments were being made to your customers?

A That was one of the largest problems that we were having at the time was whether or how long we would be in it, the questions that had been raised with our customers as to what our commitment was.

Q Mr. Butler, after your final offer on July 17, 1984, did Liggett thereafter increase its offer?

A Yes, sir.

Q How much did they increase it by, sir?

A It was another round of five cents a carton.

Q Did Brown and Williamson respond to that increase?

A No, sir.

Q Why not, sir?

A Well, the same reason we didn't respond. We couldn't. That was it. I couldn't. I didn't have the authority to do . . .

\* \* \*

[p. 70-101] Q Is that correct?

A Yes, sir.

Q All right, sir. And when Brown and Williamson was selling generic cigarettes in 1984, is it consistent with your recollection that generic cigarettes were being sold by 90 percent of its wholesalers?

A Yes, sir.

Q Mr. Butler, did you have any private label business in 1984?

A No, sir. Not in '84. No, sir.

Q Were consumers paying less or more for generic cigarettes after Brown and Williamson started selling them in 1984?

A They were paying less.

Q Why, sir?

A They were getting retail promotions that they had never gotten before. They had dollar stickers off on generic cigarettes. A lot of the rebates that were being paid were passed on through to consumers. They were paying less money.

Q Let me turn our attention now to 1985, please. To your knowledge, did Liggett's efforts to keep Brown and Williamson from selling generic cigarettes continue in 1985?

A Yes, sir.

MR. FOSTER: Objection, Your Honor, to the form of the question.

\* \* \*

[p. 70-104] letterhead?

A Yes, sir. It is.

Q And what's the date of the document?

A May 23, 1985.

Q All right, sir. Does it indicate, sir, in the third paragraph, "In May of 1985 our generic products still have 82 to 85 percent of the total generic business and has a 5 percent share of market nationally"?

A Yes, sir.

Q All right, sir. And let me ask you to look at Defendant's Exhibit 3726. All right, sir. And what's the date of this document?

A June 7, 1985.

Q All right, sir. Is it a Liggett or a Brown and Williamson document?

A It's Liggett.

Q And is it again on Mr. Parham's stationery?

A Yes, sir. It is.

Q All right, sir. And does it indicate - it's to Eli Witt? Is that correct?

A That's correct.

Q The company that Mr. Skip Eads worked for.

A Yes, sir.

Q All right, sir. Does it indicate, sir, in the second paragraph, "As we discussed, our company's market share [p. 70-105] continues to grow nationally over our competition, Brown and Williamson and R.J. Reynolds' Doral generic cigarettes"?

Does it says that, sir?

A Yes, sir. Yes, sir.

Q Does it also indicate, sir, "also, as we discussed, for every generic you sell, your gross profit is more than in Winston, Marlboro, et cetera. Do not cannibalize your generic business that you have built up by Doral and B & W sales"?

A Yes, sir. That's what it says.

Q Mr. Butler, how much success did Brown and Williamson have during the first part of 1985?

A It was very limited the first part - of the first quarter, the first part of 1985. It was very, very limited.

Q All right, sir. To your knowledge, did Liggett take any competitive action against Brown and Williamson in the first part of 1985?

A Sure. Yes, sir.

Q What, to your knowledge, did they do, sir?

A The same competitive action that we had had in the past. There was disparagement [sic] of the products, there was still the lawsuit, there was still the same actions as we had in the past that we've talked about.

Q Mr. Butler, with respect to the customers, the larger customers you had been successful [sic] in gaining distribution

\* \* \*

[p. 71-129] the price of full revenue cigarettes?

A No, sir.

Q Is there anything B & W did in offering rebates that slowed the growth of the value-for-money segment?

MR. TOPMAN: Objection. Leading.

THE COURT: Overruled.

A No, sir.

BY MR. MICHAEL ROBINSON:

Q Did B & W do anything, sir, which increased the growth of the value-for-money cigarette?

A Yes. Yes. They did.

Q What did you do, sir?

A Created a lot of competition in the marketplace with the distributors, had a lot of retail promotions on the product, offered the private consumer a better price, had competition as far as rack space, as far as product availability, as far as featuring the value-for-money cigarette brand; helped stimulate the category.

Q Mr. Butler, we've heard the terms "growth" and "rate of growth" when referring to value-for-money cigarettes, sir. Is there a difference in the definition of those terms?

A Yes, sir.

Q Well, sir, could you give us a practical application of the difference of the meaning of those terms, growth and rate of growth?

[p. 71-130] A Well, the growth is how many cigarettes that it grows, by how many cigarettes. And the rate of growth would be the percentage in which it grows.

Q Let me ask you to do -- and I tremble when I ask -- but let me ask you to do a little math with me, please, sir.

If you have a market, sir, a segment of the market that in 1984 sells 100 cigarettes ---

A Yes, sir.

Q --- and in 1985 sells 200 cigarettes ---

A Yes, sir.

Q --- what is the growth of that segment?

A That's 100 percent.

Q All right, sir.

A I passed.

Q And what is the growth in terms of the number of cigarettes?

A 100.

Q Sir, if in 1986 you sell 300 cigarettes, what is the growth in terms of the number of cigarettes?

A 100.

Q The same as for 1984 to 1985?



Q The same as for 1984 to 1985?

A Yes.

Q What's the rate of growth, sir?

A Fifty percent.

Q The number of cigarettes increased is the same, but the [p. 71-131] rate goes down?

A That's correct.

Q How's that, sir?

A Well, your base gets larger. When your base gets larger and you increase by the same number of cigarettes, your percentage goes down.

Q Mr. Butler, in your experience since 1958 in the cigarette industry, have you seen any segment, sir, where the rate of growth has decreased over time?

A Oh, ever single one of them. As they begin to grow and as they begin to get larger and larger, the rate of growth naturally goes down.

Q How did the rate of growth of generics in 1985 compare with the rate of growth of generics in 1984?

A Well, it was less.

Q Did you expect that to happen, sir?

A Yes, sir.

Q Let me ask you to look at the last exhibit, sir, the first one we looked at last Tuesday. Would you look at Defendant's Exhibit 2705 with me, please. And again, sir, I believe this is the letter from Mr. K. v. Dey to Mr. J. W. Old.

A Yes.

Q All right, sir. Let me ask you, if you would, please, sir, to turn over - if I can find it, sir - to Page 2 of that [p. 71-132] document.

Let me ask you, sir, if it says under "Environment," "The major trend in the industry continues to be the growth [sic] of the low-tar segment, 15 milligrams and below"?

A That's correct.

Q Does it say down here, sir, "We anticipate the low-tar trend to continue, however, at a decreasing rate"?

A Yes, sir.

Q Are there any segments, sir, in your experience since 1958 where the rate of growth has not decreased?

A Absolutely none.

Q Does this mean, sir, that growth stopped?

A Not at all, sir.

Q Mr. Butler, did Brown and Williamson do anything with the intent to injure competition?

A Absolutely not, sir.

Q In your opinion, sir, has competition been injured?

A No. It has not. It has been increased.

MR. MICHAEL ROBINSON: That's all sir. Thank you. If you'll answer Mr. Foster's questions.

THE COURT: All right. Ladies and gentlemen of the jury, we're going to take a recess.

It's now a quarter to 1:00. I'm going to give you until 2:15. We'll take up a couple of matters in your absence. And please remember to keep an open mind on the

\* \* \*

[p. 75-35] [A] . . . talking about percentages. The category was growing, and grew every month. It grew every month since we got in it. But any time you get into a business and any time the base gets larger, that rate of growth is going to slow. It's not going to continue growing at the same percentage rate, because with every month that goes by, with every new customer that comes in, competitor that comes in, and as this segment expands, that rate of growth is going to slow down, of course, the percentage rate. But the growth is still there.

Q And this document indicates, does it not, that your anticipation was that that rate of growth would slow after you entered the market?

A Because the segment got larger, of course. If we got in it and we expanded the base, of course, the rate of growth is going to slow, because the segment gets larger.

Q Okay, sir. Now it also says that if the GPC agreement gave you one-third of the overall generic-priced cigarette market, you would be in a more competitive market position. That was viewed as a benefit to this agreement, right?

A Well, if we're talking about one-third of the business, any time you're --- We wanted to sell all we could, and sure, you'd be in a competitive situation.

Q Isn't that because it would put you in a position of price leadership?

\* \* \*

[p. 77-103] sir?

A Yes, sir.

Q And up here at the top it says, "B & W's presence within the segment appears to have resulted in reduced consumer advertising by L & M and a slowing in the segment's growth rate."

Is that correct?

A That's what it says. And yes, sir, that's a slowing of the growth rate. And as we talked about, Mr. Foster, as the base gets larger, as that segment gets larger, then the percentage or the increase -- the rate of growth is naturally going to slow.

Q Well, that's exactly the same sentence as was contained in the document from Ms. Olges to Mr. Sandefur. Is that not correct, sir?

A That looks like it. Yes.

Q And it is a fact, is it not, sir, that B & W considered that the reduction in consumer advertising by Liggett and Myers was an aspect of Brown and Williamson's pricing strategy?

Is that not correct, sir?

A Well, sir, you're asking me to interpret the fact that Liggett and Myers had spend a lot of money in rebates against Brown and Williamson.

And if that was money that they were spending in

. . .

[p. 77-153] A Yes, they have.

Q Well, sir, I want to go over what the prices are today for cigarettes, if I might.

A Okay.

Q Let me ask you first, sir about Liggett and Myers.

A Okay.

Q And I want to make it, sir - on this board - full revenue first, sir.

A Okay.

Q Okay?

A Okay.

Q And would you tell me, please, sir, what Liggett is charging today per thousand for kingsize, full revenue cigarettes?

A Forty-eight sixty-five a thousand.

Q All right, sir. All right, sir. I want to ask you next about Philip Morris. I always do that wrong. It's one "P" - I mean one "L". Philip Morris. How much are they charging per thousand for full revenue kingsize cigarettes?

A Forty-eight sixty-five a thousand.

Q All right, sir. Now, sir, there's a method in my madness, I promise you, but I want to ask you about

American. Do you know how much they are charging for hundred millimeter cigarettes, full revenue?

A Forty-seven sixty-five.

[p. 77-154] Q All right, sir. And, finally, sir, R.J. Reynolds. How much are they charging for kingsize, full revenue cigarettes?

A Forty-eight sixty-five.

Q All right, sir. And so the record will be clear, I'm going to put on this board under "American," "100's" and for Liggett, Philip Morris, and R. J. Reynolds I'm going to put "KS" for kingsize.

A Okay.

Q All right, sir?

A Okay.

Q Now I want to ask you first about R. J. Reynolds. How much are they charging for their best-value black and white cigarettes?

A Nineteen seventy-five.

Q All right, sir. All right. And if you do the math with me, I believe, sir, that's 28.90. Does that sound right?

A Twenty-eight ninety. Right.

Q All right. Now let me ask you about American. Do they make a brand called Montclair?

A Yes, they do.

Q What is Montclair, sir?



A Montclair is a regular, full trade dress cigarette that is made only in hundred millimeter brand - styles.

Q They don't make a kingsize?

A No, not now.

[p. 77-155] Q Let me show you Defendant's Exhibits 8044, 8045 and 8046 and ask you if you can identify those, sir.

A Yes. These are the three brands that - three styles that they have in the Montclair brand.

Q To your knowledge, were they making that cigarette as a value-for-money product when this trial started?

A No, sir.

Q All right, sir.

A Well, I'm not sure whether they were or not, Mr. Robinson. I can't even remember when the trial started, but it's a new brand.

Q All right, sir. Well, let me ask you, how much are they getting for Montclair hundreds?

A Twenty-three dollars a thousand.

Q All right, sir. And that's one of the few ones that may be easy, and I'm sure I'll mess it up now. Is the difference between those two figures forty-seven sixty-five and \$23.00, is that \$24.65?

A Twenty-four sixty-five. That's right.

Q All right, sir. All right, sir. Philip Morris. Are you familiar with a brand called Bristol?

A Yes.

Q When did Philip Morris start selling Bristol, sir?

A That was this year.

Q All right, sir. Let me ask you to look at Defendant's [p. 77-156] Exhibits 8070, 8071 and 8072, and can you tell me what those are, please, sir?

A That's the three styles that they have in Bristol.

Q All right, sir. Do you know how much Philip Morris is charging for Bristol, sir?

A Twenty-one seventy-five.

Q All right, sir. All right, sir. And I believe the difference between those two is \$26.90. Is that correct?

A That's right.

Q All right, sir. Now, finally, I want to ask you about Liggett and Myers, and I want to show you first Defendant's Exhibits 10,570 and 573, 10,044 and 10,034. Can you tell me what those are, sir?

A Yes. That's Liggett and Myers' Pyramid brand.

Q All right, sir. Now to your knowledge, is Liggett selling private label cigarettes at the same price they're selling Pyramid?

A Yes, they are. Some of these.

Q How much does Liggett charge for Pyramid?

A Twenty-three dollars a thousand.

Q All right, sir. And what would that gap be? \$25.65?

A Let me use my trusty-dusty --- Yes.

Q All right, sir. Let me ask you, if you can please, sir, to tell me, what the percentage spread is between Liggett's full-revenue brand and their lowest priced private [p. 77-157] label.

A It's 52.7.

Q Percent?

A Percent.

Q All right, sir.

How about Philip Morris, between its full-revenue and its Bristol brand?

A Okay. 55.2.

Q All right, sir. And American, between Montclair and its full-revenue.

A That would be the same as Liggett and Myers. I believe that's right, isn't it?

Q Well, try it just to make sure.

A Oh, I'm sorry. No, no, no, no. Philip Morris?

Q American, sir.

A Oh, American. Okay. That would be 51.7.

Q Fifty ---

A 51.7

Q Percent?

A Percent.

Q All right, sir.

And, finally, R.J. Reynolds.

A Okay.

Q Between its full revenue and its private label - I mean generic. Best-buy.

[p. 77-158] A Is that twenty-eight ninety?

Q It's twenty-eight ninety, yes, sir.

A That's 59.4 percent.

MR. MICHAEL ROBINSON: For the record, Your Honor, I'm marking this board Defendant's Exhibit 8250.

(The board above referred  
(to was marked for  
(identification as:

(DEFENDANT'S EXHIBIT  
(NO. 8250.

MR. MICHAEL ROBINSON: And, Your Honor, at this time we would move the introduction of Defendant's Exhibits 10,034, 10,044, 10,570 and 573. Defendant's Exhibits 8044, 8045, 8046, and Defendant's Exhibits 8070, 71, and 72.

THE COURT: They are the Montclair, Bristol and Pyramid packs?

MR. MICHAEL ROBINSON: Yes, sir.

THE COURT: All right. Admitted.

(The items above referred  
(to were received into  
(evidence as:

(DEFENDANT'S EXHIBIT  
(NOS. 10,034, 10,044,  
10,570, 10,573, 8044,  
8045, 8046, 8070, 8071,  
and 8072.

MR. BARKER: Your Honor, may we approach a moment?

THE COURT: Yes.

\* \* \*

[p. 77-176] A Yes.

Q Do you know, sir, why key accounts – that term that's used by Mr. Van Scotter – had an objection to the quality of Brown and Williamson's product?

A Yes. They were told the quality was inferior to the GPC that they had had when it was manufactured by Liggett and Myers.

Q Told by who, sir?

A By Liggett and Myers' people.

Q Mr. Butler, I believe Mr. Foster questioned you on the issue of whether rebates were passed on. Do you remember that, sir?

A Yes, sir.

Q Now did wholesalers pass on rebates?

A Oh, yes, sir.

Q Why did they do that, sir?

A They passed on rebates so they could be more competitive against their competition, so they could give the retail – the retailer a lower price.

Q Let me show you Plaintiff's Exhibit 3087, which is already in evidence, sir. Now I believe Mr. Foster showed this to you and asked you about a portion of the document, and I want to refer you to another portion, please, sir.

And do you recall him indicating to you that this was a memo written by Mr. K. v. Dey?

\* \* \*

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[Excerpt Of The Trial Testimony Of H. Higgins]

[p. 89-51] say, "Yes, I believe they were ---"

MR. BARKER: Fine.

THE COURT: "--- based on information I received."

Okay. Let's go.

(End of bench conference.)

BY MR. PECK:

Q Let me just step back a minute, Mr. Higgins. In your opinion, did direct customers pass on to their retail customers the rebates they received in whole or in part from Brown and Williamson and Liggett?

A Many customers passed on either all or part of the rebate, yes, sir.

Q And what is the basis for your opinion?

A The knowledge that I have, sir, from direct discussion with the customers, the visible evidence that I have from seeing it printed in order books.

Q Can you explain what you mean by the visible printing of it in order books, sir?

A Well, the best example on that, sir, would be Southland Corporation, SDC Center, Southland Distribution Centers, which is the arm that services the -excuse me- 7-11 stores, and they also service outside customers. They're actually owned by 7-11, and they service outside customers. They gave 25 cents a carton of their rebate back to the customer for buying generics.

[p. 89-52] Another situation is Grocer Supply in Sulphur Springs, Texas. What they did was - the only place I saw this, very unusual - but they took their generic rebate and they rebated a discount on all cigarette purchases based on the monies that they received from generics. And that was given to me directly by the buyer merchandiser at Grocer Supply telling me how they were doing that.

Other situations was with - one second here.

THE COURT: Well, go ahead, Mr. Peck.

A Barry Barnett.

BY MR. PECK:

Q What was Barry Barnett?

A Barry Barnett, and I had Texas Wholesale Grocer. They discounted, and they did it off of invoice.

Q Okay. You've mentioned, sir, quarterly rebates, rebates off the invoice, and lowering the price of all cigarettes. Were there other methods used by certain customers to pass on all or some of their rebates to their retail customers?

A Yes, sir. There was another situation that I'm very aware of in Forrest City, Arkansas; Forrest City Wholesale Grocery Company ---

Q And what did they do?

A --- where they discounted other non-cigarette related items, candy, and they would lower the price on their candy actually below cost as a inducement for the

person to buy [p. 89-53] cigarettes from them. And they used the rebate monies off generics to do that.

Q Now are you familiar with J. M. Jones Company?

A J. M. Jones is a division of Super-Value.

Q To your knowledge, were they passing on any or all of their rebates?

A They were passing on rebates, yes, sir.

Q Let me show you, sir, Defendant's Exhibit 832. Sir, without going into the substance of this document, I want to get some background information about it. Can you tell me whether you received a copy of it, sir?

A Yes, sir.

Q And is it from Sharon Smith?

A That's correct, sir.

Q And what type of document is this?

A This is an executive summary, sir, of senior field manager reports that she would compile at the corporate office, and for the purpose of sending it up to the senior management, executive management, and then I also received a copy.

Q And how often, to your knowledge, was this type of report prepared by Ms. Smith?

A They were done at least monthly.

Q And was it prepared by her in the regular course of her business, to your knowledge?

\* \* \*

[p. 89-58] Q Now, sir, in your opinion, how can wholesalers pass on all or part of their rebates when they don't know what volume bracket they're going to fall into for the quarter until the end of the quarter?

A Well, they pretty well knew how much business that they were going to do. And at the worse case scenario, they knew that they would get the lowest bracket. So most of them did not pass on all of the rebates. They passed on a portion thereof. So if they passed on a portion that did not exceed their guaranteed rebate, then they weren't taking a risk of losing money.

Q Now you also mentioned, sir, that some of your customers were passing on their rebates up front, off invoice?

A Yes.

Q They were not getting --- Isn't it true, sir, that they were not getting paid the rebates from Liggett or Brown and Williamson, as the case may be, until the end of a quarter?

A That's correct.

Q Now in your opinion, sir, how could a wholesaler pass their rebates on, up front, off invoice, when they weren't getting paid that money from Liggett or Brown and Williamson until the end of the quarter?

A Well, I would view that just the same way that I view the credit terms that they give. They have to pay us, the manufacturers, on average in 14 days. Our terms are 14 days. [p. 89-59] But many distributors give 30-day terms to their retailers, so it's simply the cost of doing

business. And so if they pass these on in advance, I see that, sir, as just a cost of doing business.

Q In your opinion, sir, do wholesalers charge the same price to all of their retail customers for generic cigarettes?

A No, wholesalers don't charge the same price consistently to all customers, sir, on any of the cigarettes. Many of them have volume breaks. The higher volume a customer does --- Sometimes it's even combined with groceries. But the higher volume they do, the lower the price is, in most cases.

Q Sir, I want to turn to a different subject. When you spoke to customers in the summer of 1984, did you ever find that a customer was receiving a rebate from Liggett greater than that customer's volume would have warranted under the volume rebate published offer?

MR. FOSTER: Objection. Pure hearsay.

THE COURT: Sustained to the form.

BY MR. PECK:

Q Did you have discussions with customers as to the amounts of rebates they were getting from Liggett, sir?

MR. FOSTER: Objection

A Yes, I did.

\* \* \*

[Excerpt Of The Trial Testimony Of B. Bacon]

[p. 93-52] to 1988 of the schedule, correct?

A Based upon Brown and Williamson's assumed full-priced product, we held the gap at 35 percent, yes, sir.

Q All right, sir. I want to change subjects now, sir. Did the Brown and Williamson hierarchy approve the proposal that was set forth in the document we were just looking at, PX-4146, also called the final proposal, dated May 15, 1985?

A "Hierarchy" meaning outside of Brown and Williamson?

Q Yes. Somebody north of whomever.

A No, sir, they did not.

Q Why not?

A Two factors. One is, is that the proposal included also the launch of Hallmark, and that was not approved. And secondly is that we were told to deliver a profit which was quantified - a trading profit, which was later quantified or was quantified as \$1.00 per thousand cigarettes. That was by BATUS, more specifically Charlie McCarty, and has been known as "Charlie's dollar."

Q Now, sir, I show you a copy of what has been marked as Defendant's Exhibit 363. It's a document dated 5/22/84.

A It is, sir.

Q A Brown and Williamson document ---



A Yes, it is.

Q --- relating to the black and white launch?

A Correct, sir.

\* \* \*

[p. 93-88] MR. TOPMAN: Objection.

MR. HOGELAND: Objection.

MR. BARKER: Objection.

MR. FOSTER: Objection.

THE COURT: All right. Well, the jury will remember whatever Mr. Burnett testified to. Go ahead. Ask the question.

BY MR. LONDON:

Q Just so we have the record complete, if you would, turn please to the cover page of Exhibit 8002.

A Yes, sir.

MR. LONDON: I'm going to show this on the screen, Your Honor, because it's also part of the exhibit. I'll make a single exhibit to show the cover page and those two pages and give it to Ms. Vaughan.

THE COURT: Is that your handwriting?

THE WITNESS: Yes, sir. It is.

BY MR. LONDON:

Q And are those your initials over there? B.E.B.?

A Yes, sir. They are.

Q And a copy given to E.P.T.? That's Tucker, Eckmann and Wilson?

A That's correct, sir.

Q Over on the right-hand side?

A Yes, sir.

[p. 93-89] Q And is that your handwriting?

A Yes, sir. It is.

Q Okay. Thank you, sir. And the date in the upper left-hand corner, it says, "Revised 5/23/84."

A Yes, sir.

Q Is that your handwriting?

A Yes, sir.

Q Thank you, sir.

Now I want to change subjects so we can put that - you can put that document down for a minute.

Now, Mr. Bacon, aside from any earlier visits, which I think have been referred to as selling calls or whatever, when did Brown and Williamson announce to the trade that it would begin selling generics?

A It was on or around June 4, I believe, sir.

Q And did Brown and Williamson announce in that connection ---

A Excuse me. 1984.

Q And did Brown and Williamson announce in that connection a program of allowances, a rebate?

A Yes, sir.

Q And I want to show you what has earlier been marked in evidence as Defendant's 604A. I'm sorry. It's not in evidence. I'll hand it out.

Looking down to the paragraph in the middle of the page [p. 93-90] - of the front of the page of 604A where it says "B & W, June 4, 1984." And it has a range of rebates beginning with zero in the zip to 99 cateogry [sic], and 30 cents in the 1500 plus category. Is that right?

A That is correct, sir.

Q Now how did these allowances as announced on the June 4 first rebate schedule compare with the allowances that you put into your financial schedules in connection with the final proposal?

A If you'll recall, in the financial schedules we had a trade allowance amount of a dollar sixty-five per thousand which we translated to 33 cents a carton.

And we had - seven cents of that 33 cents was for fixtures, leaving a rebate amount included in the proposal of 26 cents a carton.

Q Let me see if I can get that straight. I'm writing those numbers on board eighty-six, eighty-six.

(The document above  
(referred to was marked  
(for identification as:  
(DEFENDANT'S EXHIBIT  
(NO. 8686.

BY MR. LONDON:

Q The financial schedules - the May financial schedules showed a dollar sixty-five a thousand.

A That is correct, sir.

[p. 93-91] Q And a dollar sixty-five a thousand is how much a carton?

A Thirty-three cents a carton. If you divide a dollar sixty-five by five ---

Q And a carton you said again ---

A Thirty-three cents.

Q Thirty-three cents. Now, sir, I ask you how that 33 cents compared with the Brown and Williamson announcement of June 4 about zip to 30, and you started to say something about fixtures.

A I said there was an amount included in that 33 for fixtures, which was seven cents a carton.

Q As noted in the memorandum that we just read into evidence a few moments ago?

A Right. My memorandum of May 24. Yes.

Q Indicating that in the dollar sixty-five was what?

A Seven cents a carton for fixtures or 35 cents of the dollar sixty-five per thousand for fixtures.

THE COURT: Well, what does that mean? Free fixtures?

THE WITNESS: Yes, sir. Yes, sir.

BY MR. LONDON:

Q So that 35 cents a thousand is seven cents a carton for fixtures?

A That is correct, sir.

[p. 93-92] Q So that the rebate in the trade allowance in the May financial was what?

A Twenty-six cents a carton.

Q Okay. It's written on Board 8686.

Now, sir, if all of your customers -- all of your customers on June 30 --- I'm sorry.

If all of your customers on June 4 came in and bought at the 30-cent level, if that happened ---

A Right, sir.

Q --- you'd be paying more trade allowances than you anticipated in your financials. Is that right?

A That is correct, sir.

Q Because you anticipated in your financials that you were going to give the customer 26 cents. Is that right?

A That is correct.

Q And you anticipated that you were also going to give to the trade seven cents worth of fixtures ---

A That is correct.

Q --- per carton. Is that right?

A That is correct.

Q So your -- in the financials your total projection for what you were going to spend was 33 cents a carton or a dollar sixty-five a thousand?

A That is correct.

Q But of that 33 cents you understood the customer would [p. 93-93] get but 26 of them in money?

A That's correct.

Q And the other seven would be put in fixture expense. Is that correct [sic], sir?

A That is correct, sir.

THE COURT: Well, now in the June 4 proposal or pricing summary the rebate is up to 30 cents or is up to a maximum of 30 cents?

THE WITNESS: Right, sir.

THE COURT: Well, I don't guess you'll finish with it. Maybe there's something about --- Is there anything about fixtures in this?

Well, you go ahead and ask the questions. I was going to ask him if there was any fixture provision. But you go ahead.

MR. LONDON: All right, sir. I'll --- Okay. I'm going to do that.

BY MR. LONDON:

Q Now let me do it this way, sir. I'll rely on the board. I'm going to write these numbers down. See? I'm improving the art now. I'm putting up a board, sir, that's just got some lines on it to try to keep my numbers in the boxes. And I marked the Board 8681.



[p. 93-94]

(The board above  
(referred to was marked  
(for identification as:

DEFENDANT'S EXHIBIT  
(NO. 8681.

BY MR. LONDON:

Q I'm going to put in this first column here the May 1984 final projection. That's the one that's attached to the final proposal. Do you understand that, sir?

A Yes, sir. I do.

Q Now the total allowance in that schedule - the total allowance was, I think you have told us ---

A It's the chart behind there.

Q A dollar sixty-five or 33 cents. Is that right?

A That is correct, sir.

MR. TOPMAN: Objection.

THE COURT: Overruled.

BY MR. LONDON:

Q And then you have told us that included in that 33 cents, as indicated in your memo, you were counting seven cents worth of fixtures.

A That is correct.

THE COURT: Okay. We've got all that. Let's go ahead.

MR. LONDON: All right.

BY MR. LONDON:

[p. 93-95] Q And so the rebate in that May financial was how much?

A Twenty-six cents.

THE COURT: It still comes out - seven - thirty-three minus seven is still twenty-six, isn't it?

THE WITNESS: There's no mystery to this.

THE COURT: Okay. Let's move on.

MR. LONDON: Yes, sir.

BY MR. LONDON:

Q If you go to that financial schedule, you had a trading profit of what?

A Two dollars and thirty-five cents a thousand or 47 cents a carton.

Q Per thousand it was how much, sir?

A Two dollars and thirty-five cents, sir.

MR. TOPMAN: Your Honor, I object to the characterization of the document that way. I don't believe that's what the line says.

THE COURT: I'm sorry. I can't hear anything you're saying.

MR. TOPMAN: Sorry, Your Honor. I object to the characterization of that line item of the exhibit. It's a much more fuller statement, sir, in terms of reserves for trading allowances on the chart.

THE COURT: Well, the jury has got it in front of them.

[p. 93-96] BY MR. LONDON:

Q That comes out to a carton of what, sir? How much a carton?

A Forty-seven cents, sir.

Q And the volume projected on that May proposal was what?

A Two point two billion units.

Q And if you made 47 cents a carton and you sold 2.2 billion sticks, your trading profit would be what?

A Five point two million dollars.

Q Five point two million?

A Yes, sir.

Q Okay, sir. Now I want to go to ---

MR. LONDON: Put up 604A again, please, David.

BY MR. LONDON:

Q --- the first offer -- the 604A offer. Was it --- The offer dealt only in rebates. Right?

A That's correct, sir.

Q And what was -- this was the offer of 0 to 30 cents. Is that right?

A That is correct, sir.

Q Now have you made a calculation as to what the weighted offer was in terms of Brown and Williamson's customers, what they got?

A Yes, sir. I've done the arithmetic.

Q And what does it come out to?

\* \* \*

[p. 93-106] trading profit level or any other level.

[MR. LONDON]: . . . The fact that they didn't do this particular analysis back then -- they didn't do Mr. Burnett's analysis either, but they're going to ask the jury to measure B & W's plans and performance against ---

THE COURT: I don't see how it adds anything to intent though, and that's what seems to be what we are talking about here.

The only point of below average cost pricing is to make an inference of predatory intent, and what does this add to that? I mean, it doesn't even help you to do it now. I mean, you're zero to 30. Nobody's contending that that's below cost, not even Burnett.

MR. LONDON: The problem is not in the first column, your honor. The first column is a hanger. Everybody agrees on the first column, even Burnett. That's right. It's the subsequent columns where people disagree.

Now I agree with Your Honor that the issue is what was Brown and Williamson's intent. Because we don't have absolute clear markers for intent, we've all come to utilize -- rightly or wrongly -- the law recognizes that we take an event, and we draw inferences from it.

We draw inferences forward, and we draw inferences backward.

The whole purpose of Burnett's testimony - his total recalculation of the books and records of the Brown and

\* \* \*

[p. 95-134] A Yes, sir, I did.

MR. TOPMAN: Your Honor, I object to the testimony about unidentified price changes, promotions in an entire six-month period of the year without some specificity - or eighteen months. I'm sorry.

THE COURT: Well, I think he can testify as to what his views were that he solicited. But when you do it, tell us more. Did it happen every time there was a rebate change or generally, or ---

BY MR. LONDON:

Q Answer the Judge's question. Did it happen every time there was a rebate change?

A Yes, sir. But let me qualify that.

Q Yes, sir.

A To the extent that I said we were talking about the period '84 - Mr. Topman said for the whole eighteen months - but I said '84 as it relates to involved [sic] on all of those changes, yes, sir.

Q All right. And did you communicate to the people with whom you were speaking, the Sandefurs and the Butlers and whomever you were dealing with, your views about how the proposed change would affect profitability?

MR. HOGELAND: Objection, Your Honor, if he can't be concrete about who he's communicating to, guys like Sandefur and Butler.

[p. 93-135] THE COURT: Who did you communicate your views to?

THE WITNESS: Mr. Sandefur, to assure him that we were always - the actions being proposed, that we were going to show - deliver a profit.

BY MR. LONDON:

Q Is that what you told him?

A Yes, sir.

Q Each time that you guys discussed a proposed change in the rebates or promotions?

A Yes, sir.

MR. TOPMAN: Same objection, Your Honor.

THE COURT: Overruled.

BY MR. LONDON:

Q Did you expect to make a profit on Brown and Williamson's generics in '84 and '85?

A Yes, sir.

Q Did you make a profit?

A Yes, sir.

Q In '84?

A Yes, sir.



Q In '85?

A Yes, sir.

Q In '86?

A Yes, sir.

MR. LONDON: I have no more questions.

\* \* \*

[p. 95-137] Q And you prepared what we've come to call as the Bacon spread sheet.

A Yes, sir.

Q And a Mr. Brumleve helped you prepare the Bacon spread sheet.

A He sure did.

Q So the Bacon-Brumleve spread sheet tells us - what you calculated in 1984 and 1985 - whether Brown and Williamson made money on generics. Right?

A Yes, sir.

Q And is it true, sir, that Brown and Williamson's careful monitoring by you and Mr. Brumleve shows that Brown and Williamson lost \$383,000 in 1984 on generics?

A That's what it shows at the trading profit line, yes, sir.

Q Let me ask you a question about that while we're here. Mr. London just put up something here and asked you about it, for 1984. He asked about July shipments of 18,000 cases, and he asked you what the trading profit was on those 18,000 cases, and you told him zero. Is that right?

A I told him we had a negative trading profit for the months of July and August because of the monies we spent for retail promotion. I believe that's what my testimony was, sir, yes, sir.

Q So he wrote down zero, and that's not right?

[p. 95-138] MR. LONDON: Objection.

A It was ---

THE COURT: Well, it's less than zero.

THE WITNESS: That's right. That was my testimony.

BY MR. TOPMAN:

Q And the way you write less than zero trading profit is you put a number down there with a parenthetical. Right?

MR. LONDON: Your Honor, I object. If he wants to argue because I put in the profit column a zero, what's he taking it up with Bacon for?

THE COURT: Okay. If you're going to ask him what the loss was for those two months, you may do so. Otherwise let's go ahead.

MR. TOPMAN: Yes, sir.

BY MR. TOPMAN:

Q And instead of having a zero trading profit, Mr. Bacon, there was a loss in June, wasn't there?

A Yes, sir. We had some spending in June and we didn't start selling any cigarettes.

Q And you had a loss in July?

A Yes, sir. That's what I was making reference to.

Q Now the Bacon-Brumleve spread sheet for '85 ---

A Yes, sir.

Q --- that also shows a loss to Brown and Williamson on generics, doesn't it?

[p. 95-139] A It shows a loss at the trading profit line, yes, of \$750,000, which I have testified to, yes, sir.

Q So Brown and Williamson, according to its own careful monitoring, concluded that it lost three-quarters of a million dollars on generics in 1985, right, sir?

A At the trading profit line, that's what it says. When you consider all the benefits, no, we don't feel we lost any money at all.

Q At the trading profit line you lost three-quarters of a million dollars, right, sir?

A At this theoretical trading profit line, that is correct, sir.

Q Theoretical?

A I think I used that term when I described that, yes, sir.

Q Do you define trading profit in your management income statements?

A Yes, sir, we do.

Q That's a real number, isn't it, sir?

A For the total corporation, it certainly is. But we don't define expenses below brand contribution as a normal course.

Q But you're not telling us that there aren't expenses below brand contribution that aren't attributable to generics, are you?

[p. 95-140] A That's why we are citing these expenses.

Q So those are real expenses that are on 3510, the Brumleve-Bacon spread sheet?

A They are not precise, but they are directional, yes, sir.

Q They are costs of dollars and cents out of Brown and Williamson's pocket, right, sir?

A With the caveat I just gave you, that they're not precise calculations as is the cost and revenues through brand contribution.

Q They're as precise as you can get them, aren't they?

A Pardon me?

Q They were as precise as you could get them?

A That's correct, sir.

Q Okay. And therefore they are real numbers, aren't they, sir?

A They are numbers, yes, sir.

Q And they are real dollars and cents?

A Yeah. A number is a number.

Q And the trading profit line is how you calculate; when you subtract the real numbers from your brand contribution level, you come up with trading profit, right?

A That's what that represents.

Q So now you're not telling me brand contribution numbers are theoretical, are you?

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**[Excerpt Of The Trial Testimony Of K. Elzinga]**

[p. 100-151] [Q] . . . monopoly power or market power in a segment even though they, at that time, were the only suppliers of the product - generic cigarettes? Correct?

Answer: "Yes."

Q Is that as you understand it to be, what you're saying in respect to you can't have monopoly power over a segment or a corner of the market, as you've phrased it?

A Yes.

Q Now, sir, you have given us your opinion that the market here is all cigarettes. But I want you to assume, for the sake of this next question, that both you and Burnett are wrong, and that I want you to assume the market is not all cigarettes, but that - I want you to assume that there is a separate market for discount cigarettes and a separate market for full revenue cigarettes.

If there were a separate discount cigarette market, in your opinion, did Brown and Williamson ever control the growth of that segment?

MR. RASMUSSEN: Objection, Your Honor. Irrelevant. As Mr. London has said, nobody is contending that there is such market.

THE COURT: All right. Did Brown and Williamson control the growth of that market, or could they control the growth of the market?

BY MR. LONDON:

\* \* \*



[p. 101-15] barrier to entry.

Q Well, in your opinion, sir, are there barriers to entry in the cigarette industry?

A Yes, I think there probably is a barrier to entry into the cigarette industry. It's very difficult to quantify it at this point in time, but that barrier would be the television advertising ban. As probably everybody knows, it is now illegal to advertise cigarettes over television. But there are lots of cigarette brands that are out there that have been in existence before that ban went into effect, so they had the advantage of being advertised over television.

Now a new entrant that wants to come into the cigarette industry can't advertise over that particular media. And to the extent it's the case, the television is a cost efficient way of advertising cigarettes to the extent that that's a cheaper way of getting the message out to people about your brand and promoting it relative to other media than to that extent. And to the extent those TV ads still rattle around in people's minds and have an impact upon their consumption behavior, to that extent the television advertising ban is a barrier to entry into the cigarette business.

Q Is it your opinion, sir, that there would likely be a new entry into the cigarette industry if that television ban were removed?

A That's a tough question, Mr. Burnett. Economists don't . . .

\* \* \*

[p. 101-17] barrier that you discussed, does this demonstrate that the firms in it are in tacit collusion with one another?

A No, it doesn't demonstrate that. A barrier to entry is a necessary condition for a cartel to be a successful and profitable one, but is not a sufficient condition.

Q Now let me refer specifically to the issue that we've been addressing here. Are there barriers to existing cigarette manufacturers that prevent them from expanding from branded production sales into producing and selling low price or discount cigarettes? Is there any barrier to that?

MR. RASMUSSEN: Objection. Irrelevant. That's not at issue in this case.

THE COURT: Overruled.

A No, there's no barrier to an existing cigarette manufacturer entering into the discount segment. That's a real easy one to answer. It doesn't involve a crystal ball. They're all in there. They've all successfully entered at this point in time. But even going back before that event took place, I don't see any barrier to entry. Mr. Cohen of Liggett indicated that there were no barriers, in his opinion, into the discount segment, and I would agree with him on that.

BY MR. LONDON:

Q All right, sir. I want to turn now to the - what I recall to be the sixth item on this industrial organizational [p. 101-18] analysis done by Mr. Burnett from which he inferred his conclusion of monopoly profits, and that is

that Liggett was or is the maverick, I think is the term he used, in the cigarette industry.

How do you understand that element to fit into Mr. Burnett's analysis, sir?

A I think I can explain that. As I understand Mr. Burnett, he attaches this character to the Liggett and Myers Company, that it was the maverick, it was the renegade, it was the firm that introduced a new price point into the cigarette industry. And none of the other firms would have done this, none of the other firms liked this to happen, and all of the firms would be economically delighted if Liggett had never done that. And consequently, there would be, in his view, an incentive on the part of all of the firms, which he believes Brown and Williamson alone picked up on, to try to get Liggett out of that segment or to at least slow the growth of that particular segment at that new price point that Liggett introduced.

Q Well, in your opinion, is Liggett a maverick?

A I would call Liggett, in this context, a reluctant maverick. It did introduce the new price point, and in that sense demonstrated independence, a breaking away from the pack, if we mean by a maverick someone who strays from the pack.

[p. 101-19] The reason I say "reluctant maverick" is, as I read the record, Liggett didn't exactly forge into the discount segment on its own initiative. Topco, one of its major customers, came to it and said, "We'd like you to bring out a new price point. We'd like you to bring out a generic black and white label." And Liggett, at first,

didn't think that was a very good idea, and they kind of balked, but Topco was persuasive. Finally, Liggett went ahead. It turned out to be that Topco's advice was – and counsel – was very good advice, and it was a successful introduction.

So I would say, yes, they were maverick, but in some sense they were a little bit different kind of maverick. It took some cajoling to get them into that role.

Q Sir, once the discount segment began to develop, did other companies behave, in your view, like mavericks, or did they show independent conduct?

A Yeah, I would certainly attach the same word to Reynolds. I think that Reynolds' introduction of Doral was just as remarkable a showing of independence or maverick-like character as the introduction of a black and white or a generic. Because Reynolds, of course, was the first to take a branded cigarette, to take a cigarette that it had been selling at full revenue prices, and drop that price down to the Liggett generic level.

I would also give a maverick grade to Reynolds for [p. 101-20] introducing and promoting the 25's which, as I indicated yesterday, is a type of discount, offering 25 cigarettes for the price of 20.

And I think American's introduction of Malibu, to take a brand that purports to be a full revenue brand and kind of perpetually sticker it at \$3.00, was a maverick-like or independent-like tactic.

Q Sir, even were we to describe Liggett and Myers as a maverick, is it the only firm – pursuant to your study,

is it the only firm with a commitment to the discount segment?

A Oh, not at all. As I indicated yesterday and I think shows through on one of the exhibits that I walked through yesterday, Reynolds has an enormous stake in the discount segment. It's the largest seller. It's commitment to Doral is very significant. That's been an important development, sales enhancer for Reynolds.

And Philip Morris has a strong commitment and a kind of different one to the discount segment. Philip Morris is in the enviable position that discount cigarettes were not, to a very great extent, cannibalizing or taking sales away from its full revenue brands. Marlboro, in particular, was sitting out there, not losing very many sales to people who were switching into the discount segment. And so Philip Morris was in this position where, when it brings out a discount cigarette, that discount cigarette is, to a large . . .

\* \* \*

[p. 101-41] didn't have enough sales in February '89 it wouldn't have an asterisk, but doesn't mean it's not out there ---

A That's correct.

Q --- is that right?

A That's my understanding.

Q And that would be the case with Brown and Williamson's Capri; is that right?

A Yes.

Q Now it's been drawn to my attention that there is an asterisk next to Capri on Page 2.

A The last entry.

Q All right, sir. Well, sir, with all of these kinds of non-list price competition that you've talked about - stickering, coupons, ad-on, advertising, new product competition, shelf payments - why isn't - in your opinion, why isn't there competition on list price as well?

A That's a good question. I thought a lot about that. I think there are two reasons why the cigarette industry seems to have a virtual absence of competition on list prices. One of them has been the topic of some discussion from a little bit different angle in this case prior to my testimony. The cigarette industry is - I won't go so far as to say it's unique, but it is - it is certainly different than most industries with regard to one characteristic of its distribution pattern, and that is a grocery wholesaler, candy [p. 101-42] and tobacco distributorm [sic] that handles cigarettes is probably going to handle the output of all six of the manufacturers, and that has an implication for list price competition.

In an oligopolistic market, when there is price competition among oligopolists, it typically occurs where the oligopolist engaging in the price cut believes that it can get some time advantage [sic] on its rival oligopolist before they are able to respond. Remember the nature of oligopoly from my discussion yesterday, it's a market setting where firms consider the likely reactions of their rivals.



And in oligopolistic competition, whether we are talking about price or non-price, oligopolists engage in competition when they think there is going to be some lag, some uncertainty in the marketplace, some at least temporary advantage that it can get over its rivals through this form of competition.

In the cigarette industry, where you have distributors who handle the merchandise of all six of the manufacturers as opposed to just one or two or three, if a cigarette company decides, "Well, I'm not going to put all of my competitive chips over on stickering and couponings. I'm going to compete on list price competition as well; I'm going to offer a price cut." That firm in the cigarette industry can pretty much count on the fact that almost immediately every other cigarette company is going to know about that form of [p. 101-43] competition. And if they all copy it, then the original firm that offered the price competition, offered the price cut, isn't any better off than it was before.

It's a matter of what forms of competition in this type of oligopoly can be quickly replicated. It's a lot harder for Brown and Williamson or Reynolds to replicate the Marlboro man, if that's the form of competition - image competition that Philip Morris chooses to adopt on that cigarette, than it would be to replicate a price cut on Marlboros.

The other factor that's going on that compliments that in the cigarette industry is - I've read testimony that, in this particular distribution channel, if a firm - if one firm raises the list price and another firm thinks, "Well, in

addition to competing on the stickering and the coupons, I'm going to compete on list price. I'm not going to raise my list price. I'm not going to follow along," there's testimony that some distributors, some wholesalers will simply go ahead and raise the price it charges on all of the manufacturers, the one that raised the list price and the one that didn't. And so the one that didn't raise its list price is, at least in that distribution channel or with those distribution outlets, not advantaged by the fact that it kept its list price at a lower level.

So there's kind of two factors going on in the [p. 101-44] distribution arrangement in this particular oligopoly, and again, I don't want to say it's unique. I haven't studied every industry, but it's different from my experience in studying industries.

Q Well, as an economist, can you tell us, in other industries does the structure of the distribution network enable competitors to change prices in a manner so that those price changes are not immediately known to competitors?

A Oh, sure. Take the television oligopoly, for example. If Panasonic decides to cut a deal with K-Mart and to offer K-Mart a very, very attractive price on Panasonic television sets so that K-Mart might have a spring special on that, well, K-Mart may be handling at most maybe one other brand of television sets. So it isn't as likely that by dint of that price reduction to K-Mart that Hitachi and Zenith and Sanyo and all of the other television manufacturers are going to know immediately about this special deal that K-Mart is going to run, so that they can immediately match or replicate that deal. So that Panasonic,

ultimately, doesn't have any sales or revenue advantage from having entered into that arrangement with K-Mart.

In the brewing industry, which is an industry that I've studied quite a bit, typically a beer distributor, let's say, a Miller distributor, doesn't handle Anheuser-Busch's beer, it doesn't handle the brands of Coors. . . . It may handle a few

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[p. 101-56] the Court three more new deposition designations: Harrison, Bagley, and Lewis, and also the revised one of Ruggiero.

Following Your Honor's suggestions, Mr. Barker and I worked it out. There's now one very minor objection; otherwise, we worked everything out.

THE COURT: All right. Thank you.

(Jury in at 11:15 a.m.)

THE COURT: All right. If the witness will come back, please.

BY MR. LONDON:

Q Dr. Elzinga, I want to change the subject a little bit, and I want to talk about income taxes for a few moments. Not yours, not mine, but Brown and Williamson's.

Mr. Burnett has testified that in his opinion any income tax savings that B & W may have enjoyed by reason of its entry into the generic segment ought not be counted for the Areeda-Turner test, the average variable cost test purposes.

Is that your understanding of his testimony?

A That's my understanding.

Q Do you agree with that?

A No. I disagree with that.

Q Why?

A I disagree with it for a couple of reasons, Mr. London. One pertains to the economic implications of handling [p.101-57] income tax or taxes the way Mr. Burnett would have it done, at least as they would apply to an Areeda-Turner test.

Mr. Burnett would say to a company, in effect, that if you have some savings on your raw materials or if you're able to come up with a way of saving money on labor costs or if you're able to buy machinery cheaper than you could buy it before, it's okay to pass all of those cost savings on to consumers. No problem under the antitrust laws with that.

Q What do you mean pass them on to consumers?

A Well, if you save a dollar on labor costs through some cost-cutting technique, you can offer that dollar in savings to the consumer and ---

Q Reflected in the price?

A That's right. You offer the consumer a dollar off. And under his calculation of prices and costs for Areeda-Turner, that would be fine.

The costs went down; the price went down. The price didn't go below cost; no violation under Areeda-Turner.

But Mr. Burnett would say to a company, "If you save any money on taxes as opposed to saving money on raw materials or labor or machinery, if the cost savings comes through an ability to reduce your tax exposure, then you may not pass that tax savings on to consumers in the form of lower prices because I'm not going to count that cost savings under Areeda-Turner. And consequently you try to offer [p. 101-58] consumers a lower price, and you may violate the Areeda-Turner test."

Now I think an interpretation – that interpretation of Areeda-Turner turns antitrust on its head because it keeps companies from being able to pass on price – cost reductions or tax savings to the ultimate consumer.

The other problem I have with his treatment of tax costs and tax savings is I think it's inconsistent. If a company has costs of operation and you suspect that this company might be a predator and you look at its costs and you find that it has costs for labor and costs for raw materials and it has costs for machinery and it has costs for taxes, well, Mr. Burnett would say, "Count all of those costs," because he thinks all of them are real costs; those that are tangible – raw materials – those that are intangible, like an excise tax payment to the federal government.

On the other hand, when it comes to tax savings to the revenue side of the equation, Mr. Burnett would say, "Well, the revenues that the consumers pay, those we want to count under Areeda-Turner. But the revenues that the firm receives in the form of tax savings, somehow those are ephemeral. They don't have any economic content to the firm, and they shouldn't be counted."

And in my judgment one should not treat tax savings and tax costs differently. I think its inconsistent. I would

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[p. 101-60] neighborhood of 80 million. Is that right? During that 18-month period?

A I don't recall, but they would be multiples of his alleged loss figure that Borwn and Williamson, in his view, sustained in going into generics.

Q Well, how does the inclusion of the LIFO tax benefits square with the rationale of the Areeda-Turner average variable cost test?

A I don't think there's any conflict. The Areeda-Turner test, as I mentioned, is a test that focuses on average variable cost.

On the cost side of the equation it says, "What are the average variable costs for this firm?" There isn't in economics a counterpart to that. There's not the concept of average variable revenue.

You could look, at least in any principles textbook that I've ever used or taught from. There's no such concept as average variable revenue. There's simply revenue.

And when Brown and Williamson goes into generics, its revenue comes in the form of two sources really on that move. One source is the sales receipts of its customers. Another source of revenue to Brown and Williamson for its move into generics was tax savings that it enjoyed as a consequence of that move.

Q Now what if one found, in the application of the test,



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[p. 101-71] [A] . . . Now I look at volume rebates – I look at them as sort of, you know, the way they are looked at conventionally.

You go to a wholesaler, you go to a distributor, you go to a direct buy retail account, and you say, "The more you buy from us, the bigger will be the rebate." That's a powerful incentive. That's an economic incentive to that distributor, to that grocery chain to buy more.

Now the only reason it wants to buy more is if it can sell more.

There was some testimony from Mr. Eads that I liked. He said something to the effect that it isn't any fun being a buyer unless you can be a seller. There's no reason to buy more from Brown and Williamson unless you plan to sell more. And the volume rebate gives you incentive and an ability to sell more.

It gives you an incentive because you can take that rebate – you can pass it on to your own customers or you can pass on a portion of it. Or you can take that rebate money, and you can expand your own merchandising efforts.

So to sum up what's been a long-winded answer – and I apologize for that, but it's such an important area of disagreement between Mr. Burnett and myself – I think the logical import of his theory is that Brown and Williamson should have been offering a reverse volume rebate.

And I disagree with him that rebates have this magic [p. 101-72] quality that they don't affect downstream

consumption. I believe that when Brown and Williamson or any cigarette company offers a customer of it a volume rebate, the only way that makes sense for that customer to take advantage of that buying more is if they sell more.

If they expand their merchandising efforts in a number of ways that are possibilities to them to expand their sales of Brown and Williamson products. And to the extent they do that, that's inconsistent, of course, with the efforts on the part of Brown and Williamson to make that discount segment get smaller or not grow as fast.

Q Let me show you, sir, and ask you a question about some of the testimony to which you refer, and that is the testimony of Mr. Eads on 8/21 – 8/21, Part V, Page 2.

The witness here is Mr. Eads, and the questioner is myself. And the question reads: "And both Liggett and Myers and Brown and Williamson were paying their customers more money per carton if the customer bought more cigarettes?"

Answer: "Yes."

Question: "And that was in a series of six or seven brackets. Right?"

Answer: "Yes, sir."

Question: "And that price structure – that rebate structure gave you as a distributor an incentive to buy more cigarettes from that manufacturer. Correct?"

[p. 101-73] Answer: "It should give the distributor the incentive to sell more product from that manufacturer, not just buy, but to sell more products from that manufacturer. Yes. On that basis, yes."

Question: "And he - the more he buys and the more he sells, the more profit he makes?"

Answer: "Yes."

Question: "And because the incentive gives the wholesaler a bigger rebate on the first carton when he moves into the next bracket, that enhances, does it not, the profit motive to the wholesaler to try and become a larger and larger volume buyer? Right?"

Answer: "Certainly."

Question: "And as you wisely pointed out, sir, it's no fun being a buyer unless you can also be a seller. Right?"

Answer: "That's right."

Question: "You want to buy, and the incentive is to buy. But if you don't want to look at the cigarettes piling up in the warehouse, if you buy then you've got to sell them?"

Answer: "I don't want one free with five and end up with six in the warehouse."

Question: "And, therefore, the incentive in the rebate program causes you as the distributor to maximize your effort to sell the product because that's the way you can maximize

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[p. 101-82] In your ---

A I'm sorry. Liggett alone?

Q Liggett.

A Uh-huh.

Q In your opinion, was consumer welfare enhanced by Liggett's introduction of discount cigarettes?

A Sure, by the same line of reasoning.

Q And can you tell from your review whether Liggett, when it was the only seller of discount cigarettes, was doing the best it could to satisfy consumer preferences?

A It's always tough to assess whether a firm that's the only seller in a market or the only seller in a segment is doing the best it could.

We can look at the track record, and we can see that as Liggett faced competition in the discount segment, it did more on behalf of consumers. It expanded its merchandising efforts. It began to sticker. It found that it could increase the size of its rebates under the goad of competition.

Liggett probably isn't any different than most of us. We do better when we are paced, when we have some competition. And Liggett seemed to offer more to consumers under the goad of competition from Reynolds and Brown and Williamson and Philip Morris and so on.

Q Well, Mr. Burnett has testified essentially that it is

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[p. 101-87] happens in the American economy, rivals appear on the scene.

[A] . . . And you can't have 100 percent and have rivals appear on the scene and continue to have 100 percent. Your share is going to decrease.

And I don't think Liggett - given its position in the industry, given the competitive character of the industry - had any ability to try and exclude rivals from the discount segment. Their track record indicates that.

Q Now, sir, You said that's the one on which they apparently had little control or no control. But you said there was a second factor that lessened their share of this discount segment, and that is one over which it did have some control, but you thought that they had made a mistake. Which one was that?

A The mistake that Liggett made - the factor over which it did have control - is that having introduced black and white generics, having introduced this new price point in the cigarette industry, they stayed too long with black and white generics.

Now I think Brown and Williamson made the very same mistake. Liggett, Brown and Williamson, put their marketing focus on black and white generics.

And not too long after this component of the market - this segment is introduced, consumers find that as between black and white generics and branded generics, which Reynolds [p. 101-88] introduces, many of them would prefer the branded generic.

And Liggett didn't recognize that early enough. I don't think Brown and Williamson did either.

And as a consequence, the discount segment started to run away from Liggett. It ran away from Liggett not just because they had new rivals in that segment, but their new rivals were Reynolds with Doral and Philip Morris with Cambridge and then American with Malibu.

And a lot of consumers found themselves thinking, "Well, I've got a choice here. I can get a low-priced cigarette with a black and white plain label or I can look in the marketplace and I can get a cigarette at the same price that's got a little brand pizzazz to it." And a lot of them said, "I'll take that latter choice."

And as I say, I think Liggett and Brown and Williamson were late in recognizing that.

Q Now, sir, do you have an opinion as to why the - aside from the move to branded generics, as to why the black and white portion of the discount segment, where Liggett was concentrating its efforts in those years, why that black and white segment has been shrinking?

A Yes. I do. I think that the cigarette industry - how shall I put this? - wasn't immunized from general forces that were happening throughout the economy with regard to black and white or generic products.

[p. 101-89] There has been in recent years a slow but steady shift away from black and white products - from generic products in the grocery business where a few years ago generic products, whether we're talking about vinegar or toilet paper or peanut butter or potato chips - a whole raft of things - was starting to make a real niche for itself in grocery retailing.

The trend has been away from that. And I think that trend, which is so common in grocery retailing, is something that the cigarette industry is not insulated from.



Q I want to show you, sir, a document which is in evidence, and it is DX-3197 in evidence.

Now this exhibit is something entitled "Private Label and Generic Analysis" put out by SAMI/Burke which has been referred to here as SAMI/Burke.

Now what is SAMI/Burke?

A SAMI/Burke ---

Q Or who - I guess it's what. What is SAMI/Burke?

A It's a what. It's an organization that tracks the flow primarily of grocery products through the distribution channel.

And it - in fairly amazing detail - will track a whole array of products so that if you and I, Mr. London, sold peanut butter in Detroit and we wanted to know what are our rivals were doing in Detroit in peanut butter, we go to [p. 101-90] SAMI/Burke and if we pay them - it's not cheap to buy this information - but if we pay them, they would draw from their data base the movement of a sample of peanut butter through the grocery wholesaling and distribution channel, even into an area like Detroit, and tell us where we stand relative to our competitors.

Q Have you ever heard of or had anything to do with the SAMI/Burke reports prior to your involvement in this litigation, sir?

A Yes. I've worked with SAMI/Burke data in other assignments.

Q Have you used this kind of data in other antitrust [sic] assignments?

A Yes. I have.

Q And you consider it reliable?

A Yes. I do.

Q Now I want to show you a particular page of this Exhibit 3197, and I've blown up what is the - counting the cover - one, two, three, four, the fifth page. It's a blow-up of the fifth page of 3197.

What does that tell us? What are we looking at, and what does it tell us, sir?

A As you indicated, it's a blow-up of a page from the SAMI/Burke document. It's a page titled "Marketing in the 80's."

[p. 101-91] And the whole sheet is designed to give a sense of the trend in the 1980's as to how private label business is doing - private label across the board, private label for corn and private label for all of the kind of products SAMI/Burke tracks. And then it has below it the regular private label.

The line that was interesting to me - the only line on this that was really interesting to me is the bottom dashed line that is labeled "Generic Label," this one right here, "Generic Label."

That line tells us, according to the SAMI/Burke data, what's happened in the 80's or at least from 1980 over to the period ending March 25 of 1988.

What's happened to generic labels that SAMI/Burke tracks?

Well, take a look at that. Over here it's one percent, so it's pretty small at the start of the decade. But it's growing. It's growing slowly.

And it peaks here in the '82-'83 period. That's probably related to macro-economic trends at the time. There's a recession going on then, so lots of people are finding

generic label to be attractive, and it really is catching the attention of the grocery business.

And a lot of grocery chains are saying, "We've got to have generic label to be competitive. A lot of our customers [p. 101-92] want that. We're moving a lot of this material."

But look what happens at this year right here beginning in 1983. There's a peak, isn't there? It's just a slight peak. But if you follow that trend, there's slow but noticeable downward trend in generics to where at the end of the period registered, generics are down to a tad more than one percent.

Now that's grocery products. That's not cigarettes. But in my view that represents a general trend for a lot of consumers that, "I'm going to trade up to a branded product. I'm not as enthused any more about shopping for generics."

And the cigarette companies that came in with the plain labels - Liggett as the introducer of that, Brown and Williamson that comes in with a plain label - that trend cuts against them, doesn't it? That's not good news for them.

The consumers generally are switching away from plain labels. Then when it comes to cigarettes, they're generally going to be switching away, not necessarily to a Kool or Marlboro, but to a branded generic.

And that's what Philip Morris and Reynolds primarily were offering. And they were the beneficiaries of that trend. I think that explains a lot as to what was happening to Liggett's declining share.

Q Some questions, sir. This general trend away from black and white packaging or private label packaging, is that [p. 101-93] something that you attribute to Brown and Williamson's conduct as something for which they are responsible?

A Oh, no, no. As I said, it not only cuts against Liggett; it cuts against Brown and Williamson as well.

Q Now, sir, this opinion that the cigarette - that you've expressed here that the cigarette growth or the consumption growth will come in the branded discount segment, is that shared, is that just your own or is that shared by other industry analysts?

A I've seen that ---

MR. RASMUSSEN: Objection.

MR. FOSTER: Objection.

THE COURT: Sustained.

BY MR. LONDON:

Q Okay. Let me show you, sir, Exhibit 36 --- Is this the right number? Well, 3657. This is Plaintiff's Exhibit 3657 offered into evidence by the Plaintiff in this trial.

That's the Maxwell Report for the 1987 year end sales. Is that right?

A That's correct.

Q I wonder if you could, sir, please turn to what is the - counting the cover page, one, two, three - the third page of the report which starts with the language up at the top, "The price value category." Do you see that, sir?

A I have it, sir.

\* \* \*

[p. 101-117] elements of our policy recommendations in this area is that antitrust enforcement be done by the government. We argued that it was a – in economics lingo – a public good and should not be provided by the private sector. Antitrust enforcement should be done by the antitrust division of the Federal Trade Commission.

But we also recommended that in the context of that enforcement, those agencies should be able to penalize violators to a far higher extent than the penalty structure now permitted. And we've moved in some direction in that area, not as far as Professor Breit and I would like.

Q But, sir, no matter how high the fines that the government might impose, that still would not allow the injured victim to get any compensation whatsoever under your proposal.

A That's correct.

Q In fact, you just mentioned Mr. Breit – you and he appeared on a panel to discuss this very issue, didn't you?

A More than one, I believe.

Q And one of the panel discussions took place in the mid-seventies, approximately ten years before you were hired by B&W's counsel; isn't that right?

A Are you referring to the American Bar Association meeting in San Francisco?

Q Yes. I think I am. It's the American Bar Association. . . .

\* \* \*

[p. 101-154] THE COURT: Page 13, bottom paragraph.

BY MR. RASMUSSEN:

Q Professor, could you read for us, on page 13 of your report, the first full sentence at the last paragraph of that page?

A Only the first sentence?

Q That's all I'd like you to read.

A All right. "We ---"

Q Go further, if you'd like.

A "We intend to study price and cost data to ascertain whether and by how much Brown and Williamson's net prices of generic cigarettes exceeded the average variable costs of producing them."

Q Go ahead and read the next sentence.

A No, I was just asking you if the first sentence was all you wanted. I'll glance at the second one.

Q I like the second, too, so go ahead and read it.

A All right. "This comparison will be based on the deposition testimony of witnesses familiar with Brown and Williamson's prices and costs, our discussions with them and on the work of Professor Roman Weil."

Q Who is Professor Roman Weil?

MR. LONDON: I object to this, Your Honor. May we approach?

THE COURT: Yes, sir. Well, let's --- What. . . .

\* \* \*



[p. 101-158] [Q] . . . started out with, which is this morning you testified that you were going to – if you were going to do a study of average variable cost, you would look at all of Brown and Williamson's cigarettes and compare their prices with their average variable costs. Now in your report you said – that you just read – you intended – you and Professor Mills intended to study the prices and the average variable costs of generic cigarettes. Isn't that right?

A Yes. Would you like me to explain that?

Q Excuse me?

A Would you like me to explain that?

Q Well, I'm coming to that right now.

A Okay.

Q And indeed the reason why this morning you said you hadn't looked to all cigarettes was because the relevant market was all cigarettes. Isn't that right?

A That's one reason.

Q But yet at the time of your report you knew that the relevant market was all cigarettes, but you still put that language in your report. Isn't that right? Look at page 13 of your report about what the relevant market – page 17 where you concluded that the cigarette market was the relevant market back in August 1986. Isn't that right?

A That's right. Am I now at the point where I can explain?

\* \* \*

[p. 101-164] [Q] . . . ascertain whether and by how much Brown and Williamson's net prices of generic cigarettes exceeded the average variable cost of producing them," close quote.

And then I asked, "Is it appropriate from an economic viewpoint to compare the net prices of generic cigarettes to the average variable cost of producing them?"

And you said, "I think it's appropriate to consider that, although in this particular instance the price narrowly defined and cost narrowly defined doesn't embrace all of the factors behind Brown and Williamson's decision to move into generics."

Isn't that what you said on October 21, 1986?

A Yes, that's what I said on October 21, 1986, and all I can say is since that time period I haven't just put my brain in neutral because something happened on October 21, 1986. I've considered to – continued to mull over these issues and --- Well, I can't expand upon what I said earlier.

Q There was no doubt in your mind at the time of your deposition which was in October 1986 that the proper market, in your opinion, was all cigarettes?

MR. LONDON: Objection. Again, that's the third time.

THE COURT: All right. One more time.  
BY MR. RASMUSSEN:

Q This was at the deposition, not the report. This was . . .

\* \* \*

[p. 101-197] Do you see where I asked him – there it is – “Did B&W price above or below average variable cost in 1984 and 1985?”

“Pre-tax trading profit was negative. Therefore, if you disregard financial consequences, other than direct sales revenue and what you refer to as price, the answer would be that prices are below average variable cost.”

And you agree with Professor Mills’ testimony, don’t you?

A I don’t really recall for certain whether pre-tax trading profit was negative. It seems to me that it was.

Q Which means then you would agree with Professor Mills’ testimony?

A Well, I agree with his answer to that question. I don’t know if I agree with his whole testimony, but he says, “Sure. Pre-tax trading profit was negative. Therefore, if you disregard financial consequences, other than direct sales revenues and what you refer to as price, the answer would be that prices are below average variable cost.” But I think Professor Mills, in the context of what he’s saying, is it would be wrong to disregard the other financial consequences.

Q In your report ---

MR. FOSTER: Objection to what he thinks Professor Mills meant. If it ---

THE COURT: All right. Sustained to that unless it’s an explanation of something further.

MR. LONDON: It’s right in the previous page of this [p. 101-198] deposition, Your Honor. Just what he objected to.

THE COURT: All right, sir. Go ahead.

MR. LONDON: The witness was absolutely correct on the previous page.

THE COURT: You may explain if it’s something from the deposition or his previous testimony.

BY MR. RASMUSSEN:

Q But, sir, when you’re looking at just prices and average variable cost of producing and distributing generic cigarettes in 1984 and 1985, and if you’re doing that on a pre-income tax basis, there is no doubt, is there, that B&W did price its generic cigarettes, pre-income tax, below the average variable cost of manufacturing and distributing them?

A Well, if you did that, which I think is the wrong comparison to make, I believe you would find that pre-tax, the price of B&W’s generics was below the average variable cost of B&W’s generics.

Q Thank you, sir.

Now, sir, I’m going to move in a minute to the tax issue, but there’s one point about cost that I want to clear up before I go into the income tax consequences.

A Okay.

Q You believe, don’t you, that imputed interest cost --- Well, let me start out – what is an imputed interest cost?

A As I understand the term, an imputed interest cost is an

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[p. 102-96] you believed it.

A Well ---

MR. LONDON: Do you have a date?

A You have to understand "Mergers: Their Causes and Cures" was written while I was a student of Dr. Adams. That was for my doctoral dissertation which he directed.

BY MR. RASMUSSEN:

Q Okay. Do you agree ---

MR. LONDON: Do you have a date on that, Your Honor, that he took the quote from?

THE COURT: What? The Scherer book?

BY MR. RASMUSSEN:

Q Do you know the date of that article, sir?

A Well, I can't remember when the article finally came out. The words would have been written back in - gracious - 1967 or '66. Those were the years I was working on my doctoral dissertation.

Q Do you agree or disagree with the following?

"According to economic theory, when consumers face a tightly knit oligopoly, the price they pay is likely to be elevated."

A Yes, in the case of a tightly knit oligopoly. That is, where the oligopolists don't compete with one another.

The prices that consumers pay - what was it - are likely to be elevated?

[p. 102-97] Q Yes.

A Yes. I agree with that.

Q And, indeed, what is the market share of the leading four firms in the cigarette industry? Approximately 85 to 90 percent, isn't it?

A I suspect so. I'll take your word for it.

Q Well, take the lower number. Now on direct in questions - in answers to questions from Mr. London you said that oligopolies are common. And you said, I think, half of the industries in the United States are oligopolies. Right?

A My recollection is in the Scherer textbook you might find an estimate on that, something like half of the manufacturing industries are considered to be oligopolies.

Q And that is using a definition of oligopoly which you gave yesterday of any industry that has 12 or fewer firms. Isn't that right?

A Not exactly. I indicated yesterday it's tough to put a number on how many firms in an industry constitute oligopoly.

I was asked and I suggested a range of from 3 to 12.

Q Okay.

A That's not to say you couldn't show me an industry with 13 firms where the firms are all fairly equally



sized and when one takes a major competitive step in one direction, it considers the reactions of some of its other rivals.

That, of course, is the essence of an oligopoly.

\* \* \*

[p. 102-99] handful of those firms that were in control of 85 percent of the market. I might still call that an oligopoly, even though, "Hey, is the number of firms between 3 and 12?" No. The number is out here at 500.

Q By your testimony yesterday you didn't mean to suggest that industries as concentrated as the cigarette industry were common, did you?

A No. I was asked whether oligopolies were common.

Q Right.

A And I said, "Well, probably half the manufacturing industries are oligopolies."

Q In fact, the chart that you just --- I want to show you a chart from Scherer's book and see if that's the chart you were just referring to. A Xerox of the chart is on Page 83.

MR. LONDON: Could we have a copy of that, please?

MR. GLAZER: We've labeled this board here Plaintiff's Exhibit 7724, the board that Mr. Rasmussen wrote those numbers on.

(The board above  
(referred to was marked  
(for identification as:

(PLAINTIFF'S EXHIBIT  
(NO. 7724.

BY MR. RASMUSSEN:

Q Now isn't it true, sir, that only about 5 percent of the industries in the United States have a concentration -- a [p. 102-100] four-firm concentration ratio of more than 80 percent?

A Well, is there a prior question as to whether this tab is the one from which I had my recollection of the 50 percent figure?

Q Is it?

A No. It's not. I thought it was in the text; that is, in the written portion. I honestly don't remember the table I'll be happy to try and answer questions from it, if you like, but I thought that -- again, this is from, you know ---

Q Let's put aside the table.

A Okay.

Q Do you agree that only approximately five percent of the industries in the United States have a four-firm concentration ratio of more than 80 percent, based on the 1982 census of manufacturers?

A As I understand your question, I think the answer is yes or at any rate, that's what the table shows.

When you say industries, you're not talking about markets then. You're talking about the government classification of SIC - what is this - four-digit probably industries?

Q Yes.

A Yes. The way the government classifies industries, which, as you know, doesn't always correlate with a real world economic market, the government finds that the number [p. 102-101] of industries with four-firm concentration ratios in 1982 ranging from 80 to 100 is 23.

And that's about five percent of all industries.

Q Now moving to another one of the elements that Mr. Burnett mentioned in his market analysis, pricing patterns. Was it your testimony that Mr. Burnett's conclusions about pricing patterns were of no help to you in trying to determine if there were monopoly level profits in the cigarette industry?

A "No help" is awkward for me to interpret. Let me see. If you're asking me was Mr. Burnett's testimony about list price uniformity persuasive to me that there was a tacit cartel, the answer would be no.

Q I gathered that. Was it of any interest to you? Was it simply an irrelevant exercise that you did?

A No. It was of interest to me. I was asked to analyze and assess his theory. Obviously, I took an interest in it. I just didn't agree with it.

Q It's something that economists look at when they do market studies, isn't it? Pricing patterns?

A Sure.

Q And this --- I want to read you something from Professor Walter Adams' book again, *The Bigness Complex*, at Page 199. You are aware that he discussed in that book the cigarette industry, aren't you?

[p. 102-102] A I don't recall that, but he may well have.

Q And he published this book in 1986?

A That's correct. I remember chapters and long discussions on steel.

Q Do you see that paragraph on the tobacco industry?

A Yes. I do.

Q And do you see at the end of that paragraph he writes - writing in 1986 that the industry - "The industry continues to exhibit extraordinarily uniform non-competitive oligopoly pricing"?

A Yes. I see that.

Q Do you disagree with Professor Adams?

A Well, I disagree with the sentence, and I disagree with the context in which you read it here.

He's talking about - and I'm quoting - "The three lineal descendants," that is of the Supreme Court. May I say that, Supreme Court opinion?

There was a Supreme Court case in 1946 that he's talking about, and he refers to the three lineal descendants of that case which are American Tobacco, Liggett and Myers, and R.J. Reynolds.

And he says, "They have collectively and unlawfully monopolized trade in part through a remarkably parallel pattern of predatory pricing and leaf tobacco purchases designed to crush independents whose competition threatened [p. 102-103] the Big Three's tacitly collusive price structure.

"No structural relief was ordered in this second case. The highly concentrated structure of the industry remained intact, and the industry continues to exhibit extraordinarily unifrom [sic] non-competitive oligopoly pricing."

Well, I would have to wonder if Walter is aware that in saying that the structure of the industry remained intact - that is, that's the quote - that Liggett has fallen into the position that it has and so has American Tobacco.

I think Walter's talking about a very different industry here, very different structural or organizational setting for the market.

Q And didn't you say this is written in 1986?

A That's correct. It was published in 1986.

Q And Mr. Scherer has a book, *Industrial Market Structure in Economic Performance*, which he published in 1990. This is the third edition. Let me show it to you.

A Thanks, I haven't seen this.

Q You've read his second edition?

A Yes, I have. I didn't know the third was out.

Q And he talks about the cigarette industry in the third edition, doesn't he?

A It appears that he does.

Q I want to read to you what he says about it.

"Despite these changes in leadership roles and the [p. 102-104] proliferation of differently priced king size, extra long, mentholated and low tar brands, there was little indication of intensified price rivalry among the cigarette makers. Indeed, despite a doubling of federal excise taxes to 16 cents per pack in 1983, the reappearance of low-priced brands and falling consumption, the leading U.S. cigarette manufacturers raised prices sufficiently to increase their profits from \$3.80 to \$11.55 per thousand cigarettes sold between 1980 and 1988."

Did I read that correctly?

A With the omission of the footnotes, you read it correctly.

Q Does Mr. Scherer have it wrong?

A Does he have what wrong?

Q Is his analysis mistaken because of what ---

A Well, if you ask me to take just this one paragraph and say do I think this reflects competition in the cigarette industry today, as I've indicated, no. I disagree with Professor Scherer if that's all he's saying.

As I've indicated, competition occurs on a number of vectors in this industry. And I also tried to explain why I thought it didn't occur on wholesale list prices.

Q These are profit margins. Profits are after you take out the non-price competition, and they've gone up from three eighty to eleven fifty-five per thousand. Isn't



that right? [p. 102-105] Aren't profits calculated after you take out your non-price competition, like stickering and shelf space payments?

A Well, are you saying that the three eighty to eleven fifty-five per thousand doesn't embrace advertising or promote its own expenditures of any sort?

Q I'm saying it does. Doesn't it?

A I'm not sure what Professor Scherer is measuring here. He's not giving a rate of return figure there. He's talking about a margin.

Q Now let's turn to accounting rates of return. Mr. London read you a passage from Franklin M. Fisher and John A. McGowan from Charles Rivers Associates which is Mr. Burnett's firm.

Did that passage - should that passage be interpreted as meaning that economists should never look to accounting rates of return in conducting a market analysis?

A Can you remind me of the passage? I think I know the thrust of it, but I ---

Q It's the one you quoted in "Unmasking Monopoly."

A Could I see that?

THE REPORTER: In - what was the title please?

MR. RASMUSSEN: "Unmasking Monopoly."

A Could I see that please?

BY MR. RASMUSSEN:

Q Sure.

[p. 102-106] You probably know the article better than I do, so you can find it. I know you quoted it.

A I'm not sure about all that at this point in time. I think you've read all this more recently than I have.

THE COURT: Okay. What is the question?

BY MR. RASMUSSEN:

Q Should we interpret or do you interpret that phrase that Mr. London read to you but didn't ask you any questions about to mean that economists should never look at accounting rates of return in trying to conduct a market analysis?

A I'm looking for a quote from the Fisher/McGowan article.

THE COURT: Well, I think that's the question. Do we need to look at that article? I mean, are you trying to ask him whether economists should look to accounting rates of return?

BY MR. RASMUSSEN:

Q You don't remember what Mr. London read yesterday in court?

A I really don't. Was it read at a bench conference or read to me?

THE COURT: Okay.

MR. LONDON: I'm handing the witness a copy of the article - the material that was read to the Professor.

I'm pointing out his mark by the orange tab at the top, and the orange highlighting on the four things that Mr. Rasmussen is [p. 102-107] asking about.

THE WITNESS: Okay.

A You're asking me do I agree with Professor Fisher and Mr. McGowan that accounting rates of return, even if properly and consistently measured, provide almost no information about economic rates of return.

BY MR. RASMUSSEN:

Q Well, you can answer that one first. Then I have another question.

A I'm somewhat on this issue like King Agrippa was when the Apostle Paul was trying to convert him. I'm almost persuaded. I moved in this direction a long ways from when I was a student of Walter Adams.

If Frank Fisher is saying never even look at them, well, I'm too interested in data to take that counsel. Where he said "provide almost no information about economic rates of return," I and a lot of economists have moved very much in that direction.

Q But you haven't gone to that extreme, have you?

A No. When I do a descriptive article on an industry and it comes to a section on profits, I put in the accounting profits. Some people are interested in those, but I try and caution the reader, "Look, you've got to look at this stuff with real caution because there's a lot of slippage between an accounting rate of return and an economic rate of [p. 102-108] return. And when you get

an economic rate of return, you still might not have a monopoly rate of return."

Q So Mr. Burnett is not the only economist that looks at accounting rates of return, is he?

A No. Not at all.

Q You do too?

A Yes. I do.

Q You mentioned risk in connection with why we should not pay any attention to accounting rates of returns. That was one of the three reasons. And you talked about products - product liability cases, health cases. Do you remember that?

A Yes. I do.

Q Isn't it true that a plaintiff has never won one of those cases and had a victory sustained on appeal?

MR. LONDON: I object.

THE COURT: Sustained. Sustained.

MR. LONDON: That is ---

MR. FOSTER: Your Honor, may we approach?

(Bench conference on the record.)

THE COURT: We're not going to start talking about court cases and what was affirmed and what was sustained.

MR. GLAZER: I just want to remind Your Honor that Mr. London cross examined about the *Chipolone* case in New Jersey where the plaintiffs won at the

trial level, and Mr. London was trying to make a point that it shows how risky

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[p. 102-128] MR. RASMUSSEN: Maybe Ken has.

THE COURT: You mean you-all can't all do that in your head?

MR. RASMUSSEN: Mr. Glazer can, I'm sure, but not me.

A Okay. Sorry for the delay. Subject to check, the figure for 1988 – the Herfindahl-Hirschman index for the cigarette industry according to the Maxwell Report stats would be 2798.

Q So it is higher in 1988 than it was in 1984?

A By that measure, yes.

Q And it's well above the 1,800 level which is the definition of high concentration in the Justice Department guidelines?

A Yes, sir.

Q Now, sir, assume after a careful nuts and bolts economic study, you determined that an industry actually had super-competitive profits – I'll use your term, monopoly profits. Would you change your mind about the existence of monopoly profits if the president of the smallest company, who was a businessman and not an economist, truthfully says that his company was making a fair profit?

A I'm sorry. I don't understand the question. You are asking me to assume that I or a group of economists I

am working with – if we decide that here's an industry that really is making monopoly profits?

[p. 102-129] Q Yes. And you do that after careful study.

A Uh-huh. And a president of a company in that industry says, "I'm only making fair profits"?

Q Yes.

A And what would I conclude from that?

Q Would you change your mind?

MR. LONDON: Your Honor, I object to the form of that question. Is he going to make the president the plaintiff who is making the allegation? There's quite a difference.

THE COURT: Well, is there a difference --- No, I'm going to --- if he can answer it, he can. If there's a difference or a similarity between fair profits and monopoly profits or do people use the terms differently. You may answer that question that he asked, if you can.

A Well, if those are the only facts I had, I probably wouldn't put a lot of weight on the testimony that the profits were fair. I might not know what the manager meant in the regard.

Q What if the manager told you – and this is a non-economist – what if the manager told you that he thought there's a lot of competition in the market every day of the year? Would you change your mind after careful economic study?

MR. LONDON: Object to this question.

\* \* \*



**[Excerpt Of The Trial Testimony Of J. Winebrenner]**

[p. 104-184] the payments that you testified about being made when Doral was reintroduced. And the first is the volume incentive. At the top level, sir, in May of 1984, how much was the payment per carton for Doral?

A At the highest level it was 16 cents per carton.

Q All right, sir. And then the next is the introductory allowance that you just mentioned. How much was that per carton, sir?

A That was 16 cents a carton.

Q All right, sir. Now I believe you mentioned terms. How much was that, sir - as compared to Liggett, how much of a benefit was that to the customer?

A I believe the differential, as stated in the other document, was about five cents.

Q All right, sir. Did you provide racks, sir?

A Yes, we did.

Q Did you charge for those?

A No, we didn't.

Q Did you provide ad slicks?

A Yes, we did.

Q Did you charge for those?

A No, we did not.

MR. MICHAEL ROBINSON: For the record, Your Honor, this easel or board is Defendant's Exhibit 8902.

BY MR. MICHAEL ROBINSON:

\* \* \*

[p. 104-211] believe Brown and Williamson or Liggett's intent was.

BY MR. MICHAEL ROBINSON:

Q Mr. Winebrenner, from your experience, sir, in marketing cigarettes and based on your observation of the value for money segment in the summer of 1984, could Brown and Williamson have competed effectively in the sale of generic products without paying rebates?

MR. TOPMAN: Objection.

MR. FOSTER: Objection.

THE COURT: Overruled.

A I believe that without the allowances, they would have had a difficult time. It would have put them at a competitive disadvantage.

BY MR. MICHAEL ROBINSON:

Q Let me ask you to look again, please, sir, at page 41 of Defendant's Exhibit 3461. Down at the bottom, sir, under Brown and Williamson, it indicates, does it not, sir, "B&W has introduced with a more favorable volume incentive trade program than either Liggett or Doral." Is that correct, sir?

A That's correct.

Q What payment or program is that referring to, sir?

A This is comparing the programs that we discussed for Doral and for Liggett that involved the escalating payment, based on number of cases purchased per quarter. And I believe in our case it was nine sixty maximum. And this one . . .

\* \* \*

[p. 104-240] MR. MICHAEL ROBINSON: Your Honor, I believe it's the one that I mismarked Defendant's Exhibit 547, which you pointed out should be 3461. It's the July 19, National Expansion Authorization.

THE COURT: Plaintiff's 7008?

MR. MICHAEL ROBINSON: No, sir.

Your Honor, here's an extra clean copy.

THE COURT: Well, I'm sure I've got it, if you'd just ---

MR. MICHAEL ROBINSON: Yes, sir.

THE COURT: All right. Go ahead. I've got it.

BY MR. MICHAEL ROBINSON:

Q Let me ask you to look down here, sir, on Page 2 of that document under, "Payback, 96.2 months." Is that the period of time, sir, that Reynolds in its national expansion document planned it would take to break even?

MR. BARKER: Objection Your Honor. Could we have a definition of what this witness means by break even?

THE COURT: Yes, sir. Sustained.

BY MR. MICHAEL ROBINSON:

Q What does the "Payback, 96.2 months," refer to, sir?

A That's the period of time at which the cumulative losses would have been offset by profit. In other words, after 96 months, the total losses would have been equaled by a profit.

Q Did Doral, in fact, lose money for the first several

\* \* \*

[p. 107-34] Q Sir, how does the profits that R. J. Reynolds makes on its tobacco business compare with profits it makes on its non-tobacco-related business?

A Generally, the tobacco profits are higher than non-tobacco.

Q Now, sir, I'd ask you to turn to your binder again, if I may, to Tab 5 of the binder. That's the Maxwell Report for 1987, right?

A Yes, it is.

Q Sir, if you'd turn to the second page of the exhibit under "Full year commentary," I'd like to read to you, sir, the second paragraph here.

It says, "As expected, the manufacturers announced price increases in December. Not only were these price hikes higher than those in the past, but the price value brand increases were even larger than those for standard price brands."

Would you agree with that statement, sir?

A Yes.

Q And the next sentence says, "Clearly, the industry is carefully watching and controlling its profit margins and making significant strides and improving the profitability of the lower-price segment as it becomes a more important contributor to sales."

Would you agree with that statement, sir?

[p. 107-35] A Yes.

Q Now, Mr. Winebrenner, you're appearing here today and the prior days at Brown and Williamson's request; isn't that right?

A The company was subpoenaed to participate and provide testimony, and I was chosen to represent the company.

Q And you met with Mr. Robinson about two or three weeks ago and went over some questions with him, didn't you, sir?

A Yes, I did.

Q And he showed you some of the documents that he was going to show you on his direct examination, right?

A Yes, he did.

Q All right. And I haven't gone over my questions with you today and two days ago, have I, sir, with you?

A No, you haven't.

Q Sir, isn't it also a fact that Mr. Robinson's firm represents R. J. Reynolds?

MR. LONDON: Objection, Your Honor.

THE COURT: Sustained.

MR. BARKER: Your Honor, may we approach?

THE COURT: All right, sir.

(Bench conference on the record.)

MR. FOSTER: Isn't that an appropriate question with regard to bias that this witness's company is represented by the same people that are here trying this case?

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[Excerpt Of The Trial Testimony Of R. Ray]

[p. 107-119] MR. MILLER: All right, sir.

BY MR. NORWOOD ROBINSON:

Q Mrs. Ray, do you recall signing a Brown and Williamson Tobacco Corporation promotional performance document such as this?

A Yes. I signed one.

Q Such as that? And did you, in fact, use the 10 cents a carton of your B & W rebate and stickering as called for in that document?

A Yes. I did.

Q How did that affect the price that the consumer paid for Brown and Williamson generic cigarettes?

A It lowered the price to the consumer.

Q As an example, if the B & W rebate were 65 cents and you used 10 cents of it for stickering, as you were required to do, then 10 cents was automatically passed to the consumer, was it not?

A That's correct.

Q And from the remaining 55 cents, is it correct that you spent that money in the ways that you have earlier described to us, that is, through the racks and five cent a carton to your salesmen and so forth?

A That's correct.

Q Did Liggett require that any of its rebates be used in stickering or promotion to the consumer?

[p. 107-120] A Occasionally in promotion, but I am not knowledgeable of any stickers that Liggett asked me to put on any products.

Q Did any of your competitors carry Brown and Williamson or Liggett generics?

A Did any of my competitors?

Q Yes, ma'am.

A I would assume so. Yes.

Q From your observation, what did your competitors do with the rebates they got?

MR. FOSTER: Objection.

THE COURT: Well, sustained.

BY MR. NORWOOD ROBINSON:

Q Do you have knowledge of what the competitors did with the rebates other than what you've already testified?

A Not other than I've testified.

Q Do you have an opinion satisfactory to yourself as to whether Brown and Williamson's offering of rebates affected competition in the cigarette market?

MR. FOSTER: Objection.

THE COURT: Overruled.

A It increased competition in the value-for-money segment.

BY MR. NORWOOD ROBINSON:

Q Can you tell us how it did that, please, ma'am, what ways it affected competition?

A Well, I would say it made us more aware as to distributors, [p. 107-121] it made us pay a lot more attention to the category. It got the consumer a variety of products to choose from at a lower price, and it made everybody come back, even Doral and Liggett, and lower their price, put more stickering out there.

And the consumer was getting a better deal.

Q Mrs. Ray, given that Liggett offered incentives on their generic cigarettes and Reynolds offered incentives on Doral, from your point of view was it necessary for Brown and Williamson to offer incentive rebates if it expected to get in this segment?

A I would not have bought the product had it not had a rebate.

Q Did Mr. Schoenheiter offer you any extra money to sell just B & W generics and to drop Liggett generics?

A No.

Q Did anyone from Brown and Williamson at any time offer you extra money or anything else to drop Liggett's cigarettes?

A No.

Q Did Mr. Schoenheiter or anyone at Brown and Williamson ever ask or even suggest that you drop Liggett cigarettes?

A No.

Q Did Mr. Schoenheiter or anyone at Brown and Williamson ever pressure you not to sell Liggett or Doral or to sell

\* \* \*

[p. 107-147] Q What is the most recently announced list price for GPC cigarettes sold by Brown and Williamson?

A We received a Mailgram this Monday that lowered the price of GPC's to 23 dollars a thousand on the king size.

Q Is that the same price as other companies' products like Pyramid and - is there another one? - product that sells?

A Pyramid, Malibu, I believe is in that price, and there's one - Bristol from Philip Morris is that price, and there may be one other one.

Q Well, then, at least four of the manufacturers today have cigarettes at that price level, right?

A That's correct.

Q In your opinion, Ms. Ray, did Brown and Williamson's introduction of its black and white cigarettes in any way result in the sale of fewer black and white cigarettes?

MR. FOSTER: Objection.

THE COURT: Overruled.

A No.

BY MR. NORWOOD ROBINSON:

Q Do you have an opinion as to why the black and whites have declined in your business while the total value for money segment has increased?

MR. FOSTER: Objection.

THE COURT: Overruled.

A The black and white has declined because the consumer [p. 107-148] has a choice of a branded product at a cheaper price now and most consumers would rather be seen with a package that has a brand identification than with a black and white package.

Q Ms. Ray, do you know of any time since you became involved in the cigarette business, when the competition between cigarette manufacturers was any greater or more vigorous than it is today?

A No.

MR. NORWOOD ROBINSON: I have no further questions, Your Honor. You may examine.

THE COURT: All right. Any questions on cross examination?

MR. RASMUSSEN: Yes. I have a few questions, Your Honor.

#### CROSS EXAMINATION

BY MR. RASMUSSEN:

Q Good afternoon, Ms. Ray, I'm Gary Rasmussen with Liggett and Myers Tobacco Company. We've never met before, have we?

A No.

Q And do you know what a deposition is?

A Yes.

Q That's where you sit down and a court reporter takes down testimony?

A Uh-huh.

Q You were never deposed in connection with this case, were . . .

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[Excerpt Of The Trial Proceedings: Court]

[p. 111-75] . . . response to the promotional price of the defendant, and the incentive is not there for the customers to look at the promoted product because the promotional price is no longer attractive. So there is another round and another round and another round.

How does a new product – a new entrant get into the market in that scenario?

MR. FOSTER: They can lower the price promotionally down to, but not below, average variable cost. If they have to lower it below average variable cost in order to get in, then they can't get in because what it means is that the existing firm is more efficient than the firm coming in.

THE COURT: I understand your position.

MR. HOGELAND: It's also ---

MR. LEFELL: Your Honor, may I respond to Mr. Foster's comment?

THE COURT: Yes.

MR. LEFELL: The law is clearly to the contrary. In any case that I'm aware of where it involves a new entrant – and I cite to Your Honor, for example, the FTC case involving General Foods – the FTC specifically held that you exclude the average variable cost test promotional price cuts. Mr. Foster is drawing on cases that don't involve new entrants altogether, and I don't see how he can argue from that to what the proper results should be in a case like . . .

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[p. 111-79] MR. RASMUSSEN: Yes. Just one small point, Your Honor. There is a growing body of law called non-price predation where predatory practices are established, not by intent documents but by conduct which is non-price conduct. Indeed, Mr. Sobol's article which I'll provide to you this afternoon is the leading treatise on it. Areeda and Turner discuss it in their treatise. The FTC is now actively looking for non-price predation cases. It is a recognized theory of predation.

THE COURT: Well, I'm not going to charge the jury, though, that they can find predation in this case, if there's above average variable cost pricing.

MR. RASMUSSEN: No. I'm not asking that, but certainly the black and white package can be regarded as non-price predation as well.

THE COURT: Well, that's some language that I can work with.

All right. We've gotten – the defendants have a number of Sherman Act type defenses under the heading of affirmative defenses, at least under the heading there of affirmative defense or business justification. Now the way the scenario will work, of course, the jury will have already found or been instructed if they – before they get to the predatory intent – I mean, affirmative defense – they will have already given some consideration to predatory intent and . . .

\* \* \*

[p. 112-85] that it was on cigarette packages, the whole thing.

Yes, sir?

MR. HOGELAND: Your Honor, I know it's the eleventh hour ---

THE COURT: Time to go.

MR. HOGELAND: --- but this whole market segment concept is also the eleventh hour. I don't think it's been in this case before today.

THE COURT: Mr. Hogeland, you wouldn't even be here if it wasn't in this case. You wouldn't have gotten past summary judgment if it wasn't in the case.

MR. HOGELAND: Well, Your Honor, I admit now it's been over a decade since I did a market segment case in the *Brown-Shoe* sense.

THE COURT: I'm going to do - I'm going to instruct them on market power in a market subsegment. I am going to - I did not mean to indicate, necessarily, the use of the words "price value" when looking at the AVC test.

MR. HOGELAND: I understand that, Your Honor. You did clarify that. But the concept of market segment in the *Brown Shoe* sense we have - this whole case has been brought here on both sides agreeing that the relevant market for entry to competition, and measuring the impact of competition, is the market for all cigarettes.

THE COURT: Right.

[p. 112-86] MR. HOGELAND: Now if the plaintiff - I confess, I'm not up on *Brown Shoe*; it's been a

decade. We have not tried this case - we have not tried to put in evidence establishing in a *Brown Shoe* context a separate market segment for generic cigarettes. I don't know whether we could have or should have, but we didn't.

THE COURT: Well, you've got to have market power somewhere and if you are saying forget the segment, I'm sure the defendants will be happy to do that, and let me charge on market power and the market as a whole.

MR. HOGELAND: I understand, Your Honor. I'm not talking forget the segment. I'm simply saying that the market segments in the *Brown Shoe* sense are not part of the Robinson-Patman Act issue. And the *Brown Shoe* criteria are criteria that have not been in this case.

THE COURT: That's fine. If the defendants don't want - I mean, if the plaintiffs don't want that, I will restrict it to the cigarette market as a whole.

MR. RASMUSSEN: Your Honor, could we have an opportunity to consider that over lunch and get back to you this afternoon on that issue?

THE COURT: No, sir. Just tell me one way or the other. I mean, I will instruct them the market power in the cigarette market as a whole.

MR. RASMUSSEN: Your Honor, we do not want an . . .

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[p. 115-10] juror, and for you, if you want.

All right. Marshal, if you'll bring the jury in, please?

(Jury in at 9:40 A.M.)

THE COURT: Good morning.

ALL JURORS: Good morning.

THE COURT: All right. Ladies and gentlemen, it's my turn now, I suppose. And you've heard all of the evidence, the arguments of counsel, and it's my duty to give you the instructions of the Court concerning the law applicable to this case.

It's your duty as jurors to follow the law as I shall state it to you and to apply that law to the facts as you find them from the evidence in the case. You are not to single out one instruction alone in stating the law, but must consider the instructions as a whole. Neither are you to be concerned with any – with the wisdom of any rule of law stated by me. Regardless of any opinion you may have as to what the law is or ought to be, it would be your violation of your sworn duty to base a verdict upon any view of the law other than that given in the instructions of the Court, just as it would be a violation of your duty as the judges of facts to base a verdict upon anything other than the evidence in this case.

Now I am going to give you this afternoon, each of [p. 115-11] you, copies of the jury charge that I am giving you now, when I get a clean copy. But I would ask you to pay particular and close attention to these instructions as I am giving them to you now, and not necessarily rely on the written copy of the instructions that I will be giving to you later.

Now in deciding the facts of this case, you must not be swayed by prejudice or favor as to any party. Our

system of law does not permit jurors to be governed by prejudice or sympathy or public opinion. Both the parties and the public expect that you will carefully and impartially consider all of the evidence in the case, follow the law as I give it to you, and reach a jury verdict regardless of the consequences.

This case should be considered and decided by you as an action between persons of equal standing in the community, and holding the same or similar stations in life. A corporation is entitled to the same fair trial at your hands as is a private individual. The law is no respecter of persons, and all persons, including corporations, stand equal before the law and are to be dealt with as equals in a court of justice.

When a corporation is involved, of course, it may act only through natural persons as its agents or employees. And in general, any agent or employee of a corporation may bind a corporation by his acts and declarations made while acting within the scope of his authority delegated to him by

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[p. 115-13] The lawyers in this case are not guilty of anything except possible overexuberance at times, and don't be concerned with anything that I may have said as a result of any evidentiary disagreements or any other discussions we had during this trial. I would be pleased to have any of the lawyers in this case represent me at any time.

So while you should consider only the evidence in the case, you are permitted to draw such reasonable



inferences from the testimony and exhibits as you feel are justified in the light of common experience. In other words, you may make deductions and reach conclusions which reason and common sense lead you to draw from the facts which have been established by the testimony and evidence in the case.

Now I said that you must consider all of the evidence. This does not mean, however, that you must accept all of the evidence as true or accurate.

You are the judges of the credibility or believability of each witness and the weight to be given to his or her testimony. In weighing the testimony of a witness, you should consider his relationship to the plaintiff or to the defendant; his interest, if any, in the outcome of the case; his manner of testifying; his opportunity to observe or acquire knowledge concerning the facts about which he or she testified; his candor, fairness, intelligence, and the extent to which he or she has been supported or contradicted by [p. 115-14] other credible evidence. You may, in short, accept or reject the testimony of any witness in whole or in part.

Also, the weight of the evidence is not necessarily determined by the number of witnesses testifying as to the existence or non-existence of any fact. You may find that the testimony of a smaller number of witnesses as to any fact is more credible than the testimony of a larger number of witnesses to the contrary.

A witness may be discredited or impeached by contradictory evidence by showing that he or she testified falsely concerning a material matter, or by evidence that

at some other time the witness has said or done something or has failed to do something, which is consistent with the witness's present testimony.

If you believe that any witness has been so impeached, then it is your exclusive province to give the testimony of that witness such credibility or weight, if any, as you may think it deserves.

Now the rules of evidence provide that if scientific, technical or other specialized knowledge might assist the jury in understanding the evidence or in determining a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify and state his opinion concerning such matter.

You should consider each expert opinion received in [p. 115-15] evidence in this case and give it such weight as you think it deserves. If you should decide that the opinion of an expert witness is not based upon sufficient education and experience, or if you should conclude that the reasons given in support of the opinion are not sound or that the opinion is outweighed by other evidence, then you may disregard the opinion entirely.

Now the burden is on the plaintiff, that is, Liggett and Myers, in a civil action such as this, to prove every essential element of its claim by a preponderance of the evidence. That's sometimes called the greater weight of the evidence. It means the same thing. Remember the example I gave when the case started about preponderance or greater weight of the evidence? That means that the plaintiff must tip those scales just slightly on its side.

There is another issue in this case that the defendant has the burden of proof on, but I will talk to you about that later in these instructions.

Now a preponderance of the evidence means such evidence as, when considered and compared with that opposed to it, has more convincing force and produces in your minds a belief that what is sought to be proved is more likely true than not. In other words, to establish a claim by the preponderance of the evidence or by the greater weight of the evidence merely means to prove that the claim is more likely [p. 115-16] so than not so.

In determining whether any fact in issue has been proved by a preponderance of the evidence, you may consider the testimony of all the witnesses, all the witnesses, regardless of who may have called them, and all the exhibits received in evidence, regardless of who may have produced them. If the proof should fail to establish any essential element of the plaintiff's claim by a preponderance of the evidence, the jury should find for the defendant as to that claim.

Now there are, generally speaking, two types of evidence from which a jury may properly find the truth as to the facts of the case. One is direct evidence, such as testimony of an eyewitness. The other is indirect or circumstantial evidence, the proof of a chain of circumstances pointing to the existence or non-existence of certain facts. The law makes no distinction between direct or circumstantial evidence, but simply requires that the jury find the facts in accordance with the preponderance of all of the evidence in the case, both direct and circumstantial.

There's an example I sometimes use to illustrate the difference between direct and circumstantial evidence. For example, suppose a mother baked a chocolate cake for dessert, and she left it in the house and went out for a while, and when she came back [sic] she found a big piece of the cake missing. [p. 115-17] And she calls her son, and she says, "Johnny, did you eat the cake I made for supper?" And he says, "No, Mother, I did not eat the cake." Well, suppose his little sister comes running up and says, "Yes, he did, too. I saw him eat the cake." That is direct evidence, the testimony of the sister.

Well, let's suppose there's no little sister around to tell on him, and he denies eating the cake. And his mother says, "Johnny, let me see your hands," and he holds out his hands and there's chocolate on them. And she looks at his lips, and she sees crumbs. Well, she hasn't seen him eat the cake, but she's seen evidence from which she can conclude that he ate the cake. That is circumstantial evidence.

During the course of the trial, I instructed you that some documents and statements were admitted for a limited purpose only and not in some instances for the truth of the statements therein, and you must follow that instruction.

When attorneys for both sides stipulate or agree to a fact, you should accept that stipulation as true and regard the fact to which they have stipulated as proven.

During the trial of this case, certain testimony has been presented to you by way of deposition, consisting of sworn recorded answers to the questions asked of the witness in advance of trial by one or more of the attorneys for the [p. 115-18] parties in the case. Such testimony is entitled to the same consideration and is to be judged

as to credibility and weighed and otherwise considered by the jury, insofar as possible, in the same way as if the witness had been presented and had testified from the witness stand.

Now as you know, there are two primary issues in this case. The first one – well, not necessarily the first one, but the one that I'm going to instruct you on first is the issue under the Robinson-Patman Act, what we have been calling generally the antitrust issue. Then I'm going to give you some instructions on the trademark issue.

[INSTRUCTION NO. 1]\*

Now as far as the Robinson-Patman Act claim is concerned, Liggett and Myers contends that Brown and Williamson's volume rebates on its black and white cigarettes in 1984 and 1985 constituted price discrimination in violation of the Robinson-Patman Act, and that it is entitled to damages as a result. On the other hand, Brown and Williamson contends that it did not violate the Robinson-Patman Act and that any loss suffered by Liggett and Myers was due to vigorous competition, changes in consumer demand, or other lawful reasons.

It is my job to inform you what the law is, and it is your job to apply the law to the facts as you see them. First, I'd like to tell you generally what the Robinson-Patman Act provides and what must be shown in order [p. 115-19] for Liggett and Myers to recover any damages.

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[\*Instruction numbers assigned by the District Court have been inserted by agreement of counsel for the convenience of the Court.]

[INSTRUCTION NO. 2]

As you know, Liggett and Myers contends that Brown and Williamson violated the act in connection with Brown and Williamson's sales of black and white cigarettes in 1984 and 1985.

Now Section 2(a) of the Robinson-Patman Act states, and I'm quoting, "It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchases of commodities of like grade and quality where either or any of the purchases involved in such discrimination are in commerce, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy or prevent competition with any person who either grants or knowingly receives benefit of such discrimination or with customers of either of them."

[INSTRUCTION NO. 3]

In order to establish its claim under the Robinson-Patman Act, Liggett and Myers must prove with respect to a set of compared black and white cigarette purchases each of the following elements by a preponderance or greater weight of the evidence:

One, that at least one of the sales being compared was made across a state line. There's no dispute about that.

Two, that each sale was for use or resale in the [p. 115-20] United States. There's no dispute about that.



Three, that the products sold were physical items. That is undisputed.

Four, that the sales being compared were made by Brown and Williamson at or about the same time. There's no dispute about that.

Five, that the products involved in the sales being compared were of like grade and quality. There's no dispute about that.

Six, that Brown and Williamson charged discriminatory, that is, different net prices to different purchasers in actual sales transactions. There is no dispute that Brown and Williamson charged different prices.

Seven, that there is a reasonable possibility that the discriminatory pricing may harm competition in the cigarette market.

And eight, that Liggett and Myers was injured in its business or property because of Brown and Williamson's discriminatory pricing.

If you find that the evidence is insufficient to prove any one or more of these elements, then you must find for Brown and Williamson and against Liggett and Myers on the Robinson-Patman Act claim.

[INSTRUCTION NO. 4]

Now as I said, six of the eight elements are undisputed, and they need not be considered by you in your [p. 115-21] deliberations. So you are instructed to find, one, that at least one of the sales of Brown and Williamson's black and white cigarettes was made across a

state line. Two, that each pertinent sale of Brown and Williamson's black and white cigarettes was for use and resale in the United States. Three, that the black and white cigarettes sold were physical items. Four, that the black and white cigarette sales being compared were made by Brown and Williamson at about the same time. Five, that the black and white cigarettes involved in the sales being compared were of like grade and quality. And six, that in the sale of the black and white cigarettes Brown and Williamson charged discriminatory, that is, different, net prices to different [sic] purchasers in actual sales transactions.

You shall not consider any of these issues further in determining whether Brown and Williamson violated the Robinson-Patman Act.

[INSTRUCTION NO. 5]

Now Section 2(a) of the Robinson-Patman Act does not make all discrimination in price concerning goods of like grade and quality unlawful. By itself, there's nothing illegal about a company engaging in price discrimination. Rather, a price discrimination within the meaning of Section 2(a) of the Robinson-Patman Act, is merely a price difference and nothing more.

In order for you to find that Liggett and Myers has [p. 115-22] established a claim under the Robinson-Patman Act, Liggett and Myers must show by a preponderance or greater weight of the evidence, one, that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market. And two,

that Liggett and Myers was injured in its business or property because of the discriminatory pricing of Brown and Williamson in the sale of black and white cigarettes.

These are the disputed issues in the case which you must decide. If you find that the evidence is insufficient to establish either one of these elements, you must find for Brown and Williamson and against Liggett and Myers.

[INSTRUCTION NO. 6]

Before instructing you further on the disputed issues which you must decide, it is important that you understand what a market and a sub-market is and the importance of these concepts to your consideration of the issues in the case.

Now the outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross elasticity - remember that phrase? - of supply and demand between the product itself and substitutes for it.

Within the broad market, well-defined sub-markets may also exist, which in themselves constitute product markets for antitrust purposes. The boundaries of such [p. 115-23] markets are determined by examining various indicators such as industry or public recognition of the sub-market as a separate economic entity, product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.

All of these factors must be examined in determining whether a well-defined sub-market exists in the broader market. The sub-market test is not merely whether what product can be substituted for the use of another product, but whether products may be reasonably interchanged for the purposes for which they are produced when prices, uses and qualities of these products are considered.

The term "sub-market" is a technical term which depends on the specific factors about which I have instructed you. It does not necessarily have the same meaning as terms you have heard in this trial such as "segment" or "category." The fact that witnesses and lawyers may refer to a "value-for-money segment" does not necessarily have any economic significance and does not establish as such the existence of a sub-market.

I have instructed you that one of the relevant factors in determining whether there is a sub-market in this case is whether the industry or the public recognizes low-priced cigarettes as a separate and distinct economic [p. 115-24] entity. This is only one of the factors you must consider, and you may not find existence of a sub-market based on consideration of this factor alone. Your decision on this question must be based on a consideration of all of the factors which I have just instructed you about.

[INSTRUCTION NO. 7]

Now an example of a market and a sub-market may further your understanding of these economic concepts. For instance, when you shop at the grocery store, lemon products are a separate market, since no other goods

serve the same purposes and uses which lemons do. In the broad lemon market, there are well-defined sub-markets such as fresh – such as the fresh lemon sub-market and the reconstituted lemon juice sub-market.

Although the end use by consumers of fresh lemons and reconstituted lemon juice is often the same, there are important distinctions between the two products such as price, consumer and industry perceptions, packaging, production facilities, quality, distribution and spoilage. Because of these distinctions, despite the similarity in and use – despite the similarity in end use by consumers, fresh lemons and reconstituted lemon juice are different sub-markets of the same broad lemon products market.

Lemons, of course, have nothing to do with this case. They just serve as an example to aid your understanding of what a market and a sub-market is.

[INSTRUCTION NO. 8]

[p. 115-25] Now sub-markets do not exist in every market. For example, 32-ounce soft drink bottles are not a well-defined sub-market of the soft drink bottle market. The reason is that 16 and 64-ounce soft drink bottles are ready substitutes for 32-ounce soft drink bottles. Although size is a unique characteristic of 32-ounce soft drink bottles, few other notable distinctions exist between 32-ounce soft drink bottles and 16 and 64-ounce soft drink bottles since contents, packaging, end use, vendors, consumer and industry perception, and sensitivity to price changes are all the same. Therefore, 32-ounce soft drink bottles are not a well-defined sub-market of the soft drink bottle market.

As with lemons, 32-ounce soft drink bottles have nothing to do with this case. They only serve as an illustration that not all markets have well-defined sub-markets.

[INSTRUCTION NO. 9]

The broad market in which Liggett and Myers claims that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition is the market for all cigarettes, branded and price value, in the United States. Neither Liggett and Myers nor Brown and Williamson dispute that the relevant market in which to evaluate a reasonable possibility of injury to competition is all cigarettes.

Liggett and Myers contends that price value [p. 115-26] cigarettes are a well-defined sub-market of the cigarette market. Brown and Williamson disputes this. The term "price value cigarettes" means the generic portion of the cigarette market, and both black and white and branded generic cigarettes are properly included under the price value label.

You must decide two things. Are price value cigarettes a well-defined sub-market of the cigarette market, and was there a reasonable possibility of injury to competition in the cigarette market as a whole due to Brown and Williamson's price value activity. Your answer [sic] to these questions are important, and I will instruct you later how your answers to these questions will affect the evidence you will consider in determining whether Brown and Williamson violated the Robinson-Patman Act.



## [INSTRUCTION NO. 10]

Once you have considered the market/sub-market question, you must distinguish between conduct which is lawful competition and conduct which is unlawful competition. Please note that mere diversion of business from one competitor to another competitor or to other competitors is not, in and of itself, unlawful.

The first element you must consider in determining whether Brown and Williamson violated the Robinson-Patman Act is whether Brown and Williamson – is whether Liggett and Myers has shown by a preponderance of the evidence that Brown and Williamson's price discrimination in the sale of black [p. 115-27] and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

## [INSTRUCTION NO. 11]

By reasonable possibility, I mean just that. It is not necessary for Liggett and Myers to establish that Brown and Williamson's price discrimination actually injured competition. Liggett and Myers need only show that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market.

On the other hand, Liggett and Myers must show more than a mere possibility of injury to competition in the cigarette market. There must be a reasonable possibility of injury to competition. Of course, if Liggett and Myers shows that actual injury to competition in the cigarette market occurred due to Brown and Williamson's

price discrimination in the sale of black and white cigarettes, then the reasonable possibility of injury to competition element is satisfied.

## [INSTRUCTION NO. 12]

By injury to competition, I mean the injury to consumer welfare which results when a competitor is able to raise and to maintain prices in a market or well-defined sub-market above competitive levels. In order to injure competition in the cigarette market as a whole, Brown and Williamson must be able to create a real possibility of both driving out rivals by loss-creating price cutting, and then holding on to that advantage to recoup losses by raising and [p. 115-28] maintaining prices at higher than competitive levels.

You must remember that the Robinson-Patman Act was designed to protect competition rather than just competitors, and therefore injury to competition does not mean injury to a competitor. Liggett and Myers cannot satisfy this element simply by showing that they were injured by Brown and Williamson's conduct. To satisfy this element, Liggett and Myers must show by a preponderance of the evidence that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market, and not just a reasonable possibility of injuring a competitor in the cigarette market.

## [INSTRUCTION NO. 13]

Earlier I instructed you whether price value cigarettes are a well-defined sub-market of the cigarette market. Your decision on that question will be very important in determining whether Brown and Williamson's activity had a reasonable possibility of injuring competition in the cigarette market. If you determine that price value cigarettes are a well-defined sub-market of the cigarette market, then as a threshold matter, before examining the injury to competition element of Liggett and Myers' Robinson-Patman Act claim, I charge you that injuring competition in the – I charge you that Brown and Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown and [p. 115-29] Williamson had market power or a realistic prospect of obtaining market power in either a well-defined price value sub-market or in the cigarette market as a whole.

If you determine that price value cigarettes are not a well-defined sub-market of the cigarette market, then as a threshold matter, before examining the injury to competition element of Liggett and Myers' Robinson-Patman Act claim, I charge you that Brown and Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown and Williamson had market power or a realistic prospect of obtaining market power in the cigarette market as a whole.

## [INSTRUCTION NO. 14]

Now market power must be distinguished from market share. Market share is the percent of sales a company

has in a market or sub-market compared to its competitors. For example, if a company has a 20 percent market share, it's competitors have an 80 percent market share.

On the other hand, market power is the power of a company to control prices and to exclude rivals in a market or well-defined sub-market. The power to control prices is simply the ability of a company to establish and to maintain higher price points for its products in a market or well-defined sub-market without suffering a loss of business to its rivals. The power to exclude rivals means the ability of a company to discipline or exclude existing rivals and to [p. 225-30] prevent new rivals from entering the market or well-defined sub-market. If other rivals can with reasonable ease take the place of any excluded or disciplined competitor, then competition cannot be injured in a market or a well-defined sub-market.

## [INSTRUCTION NO 15]

For Robinson-Patman Act purposes, market power is the relevant concept you must closely examine. The market share of a company is one factor, but not the only one, which can help you determine whether that company possesses market power. If you find that Brown and Williamson did not possess market power, then you must find for Brown and Williamson and against Liggett and Myers on the Robinson-Patman Act claim. This is because Liggett and Myers cannot demonstrate that Brown and Williamson had a reasonable possibility of injuring competition in the cigarette market unless Brown and Williamson possessed market power.

## [INSTRUCTION NO. 16]

Now if you determine that Brown and Williamson possessed sufficient market power, then a reasonable possibility of injuring competition in the cigarette market can be shown in either one of two ways. First, Liggett and Myers may show through market analysis that Brown and Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market. Or two, Liggett and Myers may show that Brown and Williamson had predatory intent from which you may [p. 115-31] infer that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

## [INSTRUCTION NO. 17]

The first way for Liggett and Myers to establish that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through market analysis. Market analysis is looking at what actually happened in the cigarette market over a relevant time period to determine whether Brown and Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market as a whole.

In making this determination, you should consider whether the cigarette market was more competitive before or after Brown and Williamson's entry into the price value business. In this regard, you may wish to consider changes in cigarette prices as a whole and the

availability of any special promotions as well as the relative price differences between full revenue branded and price value cigarettes.

If you find that Liggett and Myers has established through a preponderance of the evidence, that Brown and Williamson's conduct actually injured competition in the cigarette market, then the reasonable possibility of injury [p. 115-32] to competition element is satisfied and you need not consider whether Brown and Williamson had predatory intent.

## [INSTRUCTION NO. 18]

The second way, in addition to market analysis for Brown and Williamson - or for Liggett and Myers to establish that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through examination of Brown and Williamson's intent when it entered the black and white cigarette business.

Predatory intent, from which a reasonable possibility of injury to competition may be inferred, can be shown in either one of two ways: First, predatory intent may be inferred from proof that Brown and Williamson priced its relevant cigarette product below the reasonably anticipated average variable cost of manufacturing and selling that product over a relevant time period, and/or predatory intent may be found through direct evidence of Brown and Williamson's statements, documents or conduct.



You must remember that no matter what you decide about whether Brown and Williamson possessed predatory intent, you may only infer a reasonable possibility of injury to competition in the cigarette market from predatory intent if you find that Brown and Williamson had sufficient market power.

[INSTRUCTION NO. 19]

Predatory intent is the state of mind in which a [p. 115-33] company plans to discipline and to exclude rivals from a market or a well-defined sub-market so that it can earn higher than competitive profits on its products in that market or well-defined sub-market.

Predatory pricing happens when a company foregoes short-term profits in order to develop a market position such that the company can later raise prices and recoup profits. Predatory pricing differs from healthy competition pricing in its motives. A predator by its pricing seeks to impose losses on other firms, not garner gains for itself. Price reductions that constitute a legitimate competitive response to market conditions are not predatory.

[INSTRUCTION NO. 20]

Now to infer is to make a reasoned, logical conclusion that a disputed fact exists on the basis of another fact which has been shown to exist. The process of drawing inferences from facts in evidence is not a matter of guesswork or speculation. An inference is a deduction or conclusion which you, the jury, are permitted – but not

required – to draw from the facts which have been established by either direct or circumstantial evidence. In drawing inferences, you should exercise your common sense. For example, an inference of decreased competition may be overcome by evidence indicating that competition actually increased.

[INSTRUCTION NO. 21]

If you determine that Brown and Williamson possessed [p. 115-34] market power, the law allows you to infer that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market so long as you find that Brown and Williamson acted – at least as long as you find that Brown and Williamson acted with predatory intent. There are two ways that Liggett and Myers can show predatory intent. I will instruct you now on the first way, the average variable cost test.

Earlier I instructed you that you must determine whether price value cigarettes are a well-defined sub-market of the cigarette market. This decision is crucial to your proper application of the average variable cost test. I will explain the average variable cost test to you shortly, but right now you must understand that you cannot apply this test correctly until you determine whether price value cigarettes are a well-defined sub-market of the cigarette market.

If you find that price value cigarettes are a well-defined sub-market of the cigarette market, then, in applying the average variable cost test, you must look at whether Brown and Williamson priced its black and white

cigarettes below reasonably anticipated average variable cost. If you find that Brown and Williamson did price its black and white cigarettes below reasonably anticipated average variable cost, then you may – but need not – infer that Brown and Williamson had predatory intent.

[p. 115-35] On the other hand, if you find that price-value cigarettes are not a well-defined sub-market of the cigarette market, then you should not apply the average variable cost test since there is no evidence that Brown and Williamson priced its full line of cigarettes, branded and price value, below reasonably anticipated average variable cost.

The average variable cost test is a double-inference test, because if you find that Brown and Williamson priced below its reasonably anticipated average variable cost, you may infer that Brown and Williamson had predatory intent, and from predatory intent you may infer that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market as a whole.

#### [INSTRUCTION NO. 22]

Now I would like to take a moment and explain the component parts of the average variable cost test to you. Costs are divided into fixed costs and variable costs.

Fixed costs do not vary with the number of goods that a company produces and sells. Because these costs are incurred regardless of the quantity of products sold, you should not consider fixed costs in determining whether Brown and Williamson's prices were predatory.

Variable costs, on the other hand, are those costs which increase or decrease directly with changes in output. Average variable cost is the sum of all variable costs divided by the total number of units of output in a relevant [p. 115-36] time period. Remember, variable costs, those costs that change directly with a company's output, are the only relevant costs for purposes of the average variable cost test.

The determination of which costs are variable and which are fixed is a matter for you to decide. You should only apply the test if you find that price value cigarettes are a well-defined sub-market of the cigarette market. If so, to apply the test you must determine what Brown and Williamson's average variable cost was for black and white cigarettes and then determine whether the net prices Brown and Williamson charged for its black and white cigarettes were above or below reasonably anticipated average variable cost.

#### [INSTRUCTION NO. 23]

Once you have determined Brown and Williamson's reasonably anticipated average variable cost, you must decide whether or not Brown and Williamson priced below reasonably anticipated average variable cost. Price here means the net price.

Net price equals list price minus all discounts to the customer. You must remember that customer means the wholesalers and the direct-buying retailers to whom Brown and Williamson directly sold its black and white cigarettes. You should not equate customer with consumer.

## [INSTRUCTION NO. 24]

Remember there are several steps that you must go [p. 115-37] through in applying the average variable cost test. Now you've heard testimony from the various experts concerning their figures and their determinations applying the average variable cost test.

If you want to go through the exercise and apply it yourself, first you must decide whether price value cigarettes are a well-defined sub-market of the cigarette market. If you find that price value cigarettes are a well-defined sub-market, then you must decide the total net price of Brown and Williamson's black and white cigarettes. You do this by determining the dollar value of Brown and Williamson's black and white cigarette sales in the United States over a relevant time period. Then you must calculate the reasonably anticipated average variable cost of Brown and Williamson's total black and white cigarette output in the United States.

You calculate this by adding up all of the reasonably anticipated average variable – you calculate this by adding up all of the reasonably anticipated variable costs Brown and Williamson spent in manufacturing and selling black and white cigarettes in the United States over the same relevant time period which you used in deciding Brown and Williamson's total dollar sales. Then you compare your total price figure with your reasonably anticipated average variable cost figure. Only if Brown and Williamson's black [p. 115-38] and white cigarettes are priced below reasonably anticipated average variable cost may you infer predatory intent from this cost price evidence.

If you find that price-value cigarettes are not a well-defined sub-market of the cigarette market, then you must not apply the average variable cost test since there is no evidence that Brown and Williamson priced its full line of cigarettes, branded and price value, below reasonably anticipated average variable cost.

## [INSTRUCTION NO. 25]

Liggett and Myers contends that the appropriate time period for determining whether Brown and Williamson priced below its reasonably anticipated average variable cost is the 18-month period from June 1984 through December 1985.

Brown and Williamson, on the other hand, contends that you should look at the entire period from June 1984 to present, or at least from June 1984 through June 1987, to determine whether Brown and Williamson priced below its reasonably anticipated average variable cost.

It is for you to decide what the relevant time period is for determining whether Brown and Williamson priced below its reasonably anticipated average variable cost. In determining the relevant time period, you may use Liggett and Myers' time period or you may use either of Brown and Williamson's time periods, or you may want to arrive at a different time period which you consider relevant.



## [p. 115-39] [INSTRUCTION NO. 26]

In determining whether prices are predatory, you must look at what Brown and Williamson reasonably believed its net prices and average variable cost would be. If you find that Brown and Williamson reasonably believed that its average variable cost would not exceed its net prices, but, that for unforeseen reasons, its average variable cost actually did exceed its net prices, then you must find that Brown and Williamson did not price below its reasonably anticipated average variable cost.

## [INSTRUCTION NO. 27]

—You must remember that the average variable cost test only creates an inference of predatory intent. Even if you find that Brown and Williamson priced its black and white cigarettes below its reasonably anticipated average variable cost, you may reject the inference of predatory intent. For example, this inference may be rejected if you find that Brown and Williamson was attempting to gain entry into a new portion of the cigarette business and offered net prices below reasonably anticipated average variable cost on an introductory basis only.

## [INSTRUCTION NO. 28]

Also, you may, if you wish, reject an inference of predatory intent if you find that a substantial motivation for Brown and Williamson's entry into black and white cigarettes was LIFO decrement avoidance tax benefits.

In your deliberations you should consider, for example, whether Brown and Williamson actually obtained

LIFO [p. 115-40] decrement avoidance tax benefits as a result of selling black and white cigarettes, or whether Brown and Williamson actually considered LIFO decrement avoidance tax benefits when it decided to enter the black and white cigarette business, or whether LIFO decrement avoidance tax benefits were a substantial motivation for Brown and Williamson's entry into black and white cigarettes since Brown and Williamson incurred additional costs, including start-up costs, due to the generic venture which possibility offset the tax savings from LIFO decrement avoidance. Remember that start-up costs often are used for new assets which have a long life, however.

## [INSTRUCTION NO. 29]

The second way that Liggett and Myers can establish predatory intent is through direct evidence of Brown and Williamson's statements and conduct. Statements that show predatory intent can be oral or written statements by Brown and Williamson personnel. In determining what weight to give these statements, you may consider whether the person making the statement had a voice in directing Brown and Williamson company policy and whether the person making the statement had direct responsibility for the particular subject matter in question.

Conduct can also indicate predatory intent. For example, if you find that Brown and Williamson knowingly copied Liggett and Myers' quality seal and leaf design, you [p. 115-41] may consider this as some direct

evidence that Brown and Williamson acted with predatory intent. You must determine the weight to give to Brown and Williamson's conduct.

[INSTRUCTION NO. 30]

When you consider direct evidence of predatory intent, you must be very cautious. The true intent of statements and conduct is often difficult to discern. Documentary evidence of predatory intent can be especially misleading and ambiguous, because the exact meaning of words is sometimes unclear and business people often use aggressive words to describe lawful competitive activity.

For instance, I have allowed you to hear some evidence regarding U.S. Tobacco and Georgopulo Company for the limited purpose of providing a yardstick to assist you in evaluating the competitive terminology used in business documents, and evaluating the effectiveness of using lower list prices as a way of competing for consumers at retail, if you find that the experiences of U.S. Tobacco and Georgopulo Company were considered by Brown and Williamson when it made its pricing decisions regarding black and white cigarettes.

You must remember, as I have told you before, there is no contention in this case that Liggett and Myers' conduct with respect to U.S. Tobacco and Georgopulo Company injured competition in the cigarette market. Neither U.S. Tobacco nor Georgopulo Company have any claims against Liggett and Myers in connection with any of the evidence you have heard [p. 115-42] in this case.

[INSTRUCTION NO. 31]

Liggett and Myers must show more than just a reasonable possibility of injury to competition in the cigarette market in order to prove that Brown and Williamson violated the Robinson-Patman Act. The law provides that it must be the price discrimination which causes the reasonable possibility of injury to competition.

In this case, unless Liggett and Myers proves by a preponderance of the evidence that a reasonable possibility of injury to competition in the cigarette market was caused by differences in the prices Brown and Williamson charged for its black and white cigarettes, then Liggett and Myers has failed to carry its burden.

Several examples may be useful here. First, if you find that the reasonable possibility of injury to competition resulted merely from low prices, then you must find that Brown and Williamson's price discrimination did not create any reasonable possibility of injury to competition. Second, if you find that some other aspect of Brown and Williamson's conduct other than price discrimination caused a reasonable possibility of injury to competition in the cigarette market, then you must find that Brown and Williamson's price discrimination did not create a reasonable possibility of injury to competition in the cigarette market.

On the other hand, if you find that price [p. 115-43] discrimination facilitated or made possible predatory conduct by Brown and Williamson, then you may find that it was the price discrimination which had a reasonable possibility of injury to competition in the cigarette market.

Remember, even if you decide that Brown and Williamson's conduct created a reasonable possibility of injury to competition in the cigarette market, you must find for Brown and Williamson and against Liggett and Myers if the conduct which created this threat to competition was something other than Brown and Williamson's price discrimination in the sale of black and white cigarettes.

[INSTRUCTION NO. 32]

If you find that Liggett and Myers has established by a preponderance or greater weight of the evidence, the elements of its claim under the Robinson-Patman Act, that is, you have found that Brown and Williamson's price discrimination had a reasonable possibility of injuring competition in the cigarette market as a whole, then you must find that Brown and Williamson has violated the Robinson-Patman Act, unless Brown and Williamson has established an affirmative defense under Section 2(b) of the Robinson-Patman Act.

Now an affirmative defense is one that Brown and Williamson has the burden of proving by a preponderance of the evidence. Section 2(b) of the Robinson-Patman Act states in general that - and this is a paraphrase - "nothing herein [p. 115-44] contained shall prevent a seller rebutting the evidence by plaintiff indicating a possible violation of the Robinson-Patman Act by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor."

[INSTRUCTION NO. 33]

To establish the affirmative defense of meeting competition, Brown and Williamson must show by a preponderance of the evidence that it lowered its net prices of black and white cigarettes to customers in good faith with the intention to meet but not beat the equally low net price of Liggett and Myers' black and white cigarettes.

Good faith is the most important element of this defense. Good faith is shown if Brown and Williamson reasonably believed, over the relevant time period, that the net prices of its black and white cigarettes were meeting but not beating the equally low net prices of Liggett and Myers' black and white cigarettes.

Even if the net prices of Brown and Williamson's black and white cigarettes were actually lower to customers than Liggett and Myers' net prices, the defense is not lost if Brown and Williamson establishes by a preponderance of the evidence its good faith.

[INSTRUCTION NO. 34]

You must remember that even if all of the elements [p. 115-45] of the Robinson-Patman Act are established, Brown and Williamson has an absolute affirmative defense if it shows that its black and white cigarettes' net prices were set in good faith to meet but not beat the equally low prices of Liggett and Myers' black and white cigarettes. If Brown and Williamson proves the meeting competition defense by a preponderance of the evidence, you must find that Brown and Williamson did not violate the Robinson-Patman Act. Only if you find that Brown



and Williamson is not entitled to the meeting competition defense, may you consider damages.

[INSTRUCTION NO. 35]

If you find that Liggett and Myers has established by a preponderance of the evidence that Brown and Williamson violated Section 2(a) of the Robinson-Patman Act, and if you find that Brown and Williamson has not proven by a preponderance of the evidence the Section 2(b) affirmative defense on meeting competition, then you must consider whether Liggett and Myers is entitled to recover damages.

In order for you to determine that Liggett and Myers is entitled to damages, you must find that Liggett and Myers has proven by a preponderance of the evidence the following: One, that Liggett and Myers was in fact injured in its property or business; two, that Liggett and Myers suffered this injury due to Brown and Williamson's violation of the Robinson-Patman Act; and three, the amount of damages that Liggett and Myers has incurred.

[p. 115-46] [INSTRUCTION NO. 36]

I will now explain each of these elements to you further. Liggett and Myers can establish it was injured in its business or property if, by direct reason of Brown and Williamson's violation of the Robinson-Patman Act, it shows that it suffered financial losses in the period from June 1984 through December 1985, or another shorter time period which you are free to determine. These losses

may include out-of-pocket expenses such as rebates or diminished returns on investment.

[INSTRUCTION NO. 37]

Next, Liggett and Myers must show that Brown and Williamson's price discrimination was a material cause of Liggett and Myers' actual injury. In making this determination, you may consider whether explanations other than Brown and Williamson's price discrimination were the real causes of Liggett and Myers' actual injury. These alternative explanations include, among others, one, competition by other cigarette manufacturers for full revenue branded sales; two, falling consumer demand in the cigarette market; or three, Liggett and Myers' own management shortcomings; or four, loss of consumer sales of black and white cigarettes which Liggett and Myers sold due to more popular branded generic cigarettes which Liggett and Myers did not sell.

You must remember that Liggett and Myers need not prove that Brown and Williamson's price discrimination was [p. 115-47] the sole cause of Liggett and Myers' actual injury, nor must Liggett and Myers show that Brown and Williamson's price discrimination was a more substantial cause of injury than any other.

Liggett and Myers, however, must show that Brown and Williamson's price discrimination played a substantial part in causing Liggett and Myers' actual injury. Therefore, Liggett and Myers may not recover damages if you find that Brown and Williamson's conduct was not a material cause of Liggett and Myers' actual injury.

## [INSTRUCTION NO. 38]

Finally, in order for Liggett and Myers to receive damages, it must provide sufficient evidence for you to determine the amount of damages it suffered from Brown and Williamson's illegal conduct. In determining a proper award of damages for Liggett and Myers, you must separate damages to Liggett and Myers from the lawful competitive activities of Brown and Williamson and the other cigarette manufacturers from damage to Liggett and Myers due to Brown and Williamson's illegal activities. Liggett and Myers may only recover damages for the illegal activities of Brown and Williamson.

Once Liggett and Myers has proven that it was, in fact, injured and that Brown and Williamson's conduct was a material cause of its injury, Liggett and Myers' burden of proving the amount of damages is somewhat lightened. You are [p. 115-48] allowed to determine the amount of damages Liggett and Myers incurred based on the evidence which shows the extent of damages as a matter of just and reasonable inference, although the result may be only approximate.

However, this burden is not established by mere speculation and guesswork. Liggett and Myers is still required to put forward substantial and relevant evidence from which damage can be reasonably approximated.

Now you also know that Liggett and Myers has a trademark claim in this case, and Liggett and Myers has been granted three federal trademark registrations for the quality seal from the United States Patent and Trademark Office. These trademark registrations give Liggett and

Myers a legal presumption that the quality seal is a valid trademark, that Liggett and Myers exclusively owns the quality seal and that Liggett and Myers has the exclusive right to use the quality seal in connection with the sale of cigarettes. Defendant has not contested the validity of Liggett and Myers' federal registration and trademark for its quality seal. You are therefore instructed to find that the quality seal was and continued to be a valid protectable trademark as of July 1983, the date set forth in Liggett and Myers' registrations.

Liggett and Myers has also been granted United States trademark registration for its leaf design. Plaintiff

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[p. 115-138] . . . you see, urges it.

I'm just rarely in a position of doing it, and I think it will cut down on numerous questions, although we are going to get some questions - I'll be amazed if we don't - from the jury.

But I have been delayed in getting a clean copy. And, of course, I've had to write in here.

So whether I'll get that to them before 5:00 today, I don't know. But we will see.

Let's get the jury in. Do this. Let them get started. We'll talk about the exhibits. They have all the documentary exhibits available to them now with the turn of a key.

All right, Marshal, if you would, please.

MR. FOSTER: Do I understand, Your Honor, that you are not going to make any change in the trademark instruction?

THE COURT: Right.

MR. FOSTER: All right. Thank you.

THE COURT: I read some more cases on that, too.

(Jury in at 2:15 p.m.)

All right, ladies and gentlemen, I'm going to – sorry that you were delayed, but we are going to be ready here in just minute for you to begin your deliberations.

But we've had some extensive discussions in these [p. 115-139] two perhaps complicated areas of the law, making it easy for you to understand and clarifying anything that I have given.

And I'm going to give you one instruction that I think clarifies the definition of market and sub-market somewhat, and then I'm going to give you another instruction about calculating average variable cost that I had an inadvertent error in it that – particularly when you see the written copy of the charge – could have led you astray. You will probably not notice that much difference in the charge.

But you remember I instructed you about markets and sub-markets and said within the broad market well-defined sub-markets may also exist, which, in themselves, constitute product markets for antitrust purposes.

The boundaries of such sub-markets are determined by examining various indicators such as industry or public recognition of the sub-market as a separate economic entity.

The product's particular characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors – I told you that all of these factors must be examined in determining whether a well-defined sub-market exists in the broader market.

However, I want to point out to you now that the existence of a sub-market or its lack of existence does not require the presence or absence of all of the factors that I [p. 115-140] have just given you.

I said you must examine all of the factors, and then I went on to say the sub-market test is not merely whether one product can be substituted for the use of another product but whether products may be reasonably interchanged for the purpose for which they are produced when prices, uses, and qualities of the product are considered.

Now I also instructed you earlier about – if you wish to make your own calculation of the average variable cost test.

And you have, of course, seen calculations made by the experts, and Mr. Bacon, and others who have testified here in court.

But there are several steps you must go through in applying the average variable cost test, and I'm going to go back through it one more time, having made the change that I missed in the first one – the first time.

First, you must decide whether price value cigarettes are a well-defined sub-market of the cigarette market.



Second, if you find that price value cigarettes are a well-defined sub-market, then you must decide the total net price of Brown and Williamson's black and white cigarettes.

You do this by determining the dollar value of Brown and Williamson's black and white cigarette sales in the [p. 115-141] United States over a relevant time period.

Third, then you must calculate the reasonably anticipated average variable cost of Brown and Williamson's total black and white cigarette output in the United States.

Fourth, you calculate this by adding up all of the reasonably anticipated variable costs Brown and Williamson spent in manufacturing and selling black and white cigarettes in the United States over the same relevant time period which you used in deciding Brown and Williamson's total dollar sales.

Fifth, then you compare your total price figure, as measured by sales over a relevant time period, with your reasonably [sic] anticipated total variable cost figure, as measured over the same relevant time period.

Only if Brown and Williamson's black and white cigarettes are priced below reasonably anticipated average variable cost may you infer predatory intent from this cost pricing evidence.

And sixth, if you find that price value cigarettes are not a well-defined sub-market of the cigarette market, then you must not apply the average variable cost test since there is no evidence that Brown and Williamson

priced its full line of cigarettes, branded and price value, below reasonably anticipated average variable cost.

Now I still intend to send a typewritten copy of [p. 115-142] the entire charge in to you - hopefully this afternoon; if not, first thing in the morning - along with the verdict sheet.

But I am going to ask you now to go in your jury room and begin your deliberations. If anything occurs, please don't leave the jury room but contact the Marshal.

And we will be asking you to come back in at 5:00 o'clock today, assuming you are still deliberating. And we'll be dismissed until 9:30 tomorrow morning.

If you are at a particular point and don't want to come in right on the minute, you can say so.

But, as I said, you are going to be able to go back to your hotels or homes and go about your business.

Just remember, of course, the instructions I've given you about not discussing the case except when the nine of you are together there in the jury room and after you have been checked in court after 9:30 in the morning.

All right, Marshal.

(Jury out at 2:30 p.m.)

THE COURT: All right. I think we had some question about some exhibits. I just want to, you know, point out one more time, in light of the instruction about the market and the sub-market, the reason for it.

You, know, throughout this case Liggett and Myers has claimed that Brown and Williamson's conduct had a . . .

\* \* \*

[p. 123-8] . . . understand the question, if I understand the question.

Here is the question. I'm quoting. Well, the preamble to the question is, quote, "The jury requests more information on market power as some of the instructions are sought - or are sort of unclear to us at this time. Any help would be appreciated."

Now with that premise, we go on to the next paragraph. Please note. They're going to refer to Instruction 18 and Instruction 17, but I think they've got those reversed and I'll tell you why when I read it. I'm quoting now. "On Instruction Number 18, tells us that B&W did not have to have market power." Well, it doesn't tell them that. First, look at 18, the bottom of the page. We're talking about inferring a reasonable possibility of injury to competition in the cigarette market from predatory intent. "If you find that that Brown and Williamson had sufficient market power -" Well, that also ought to be "or a realistic prospect of obtaining market power."

But look at 17. I think when they are saying 18 there, they are talking about 17 because 17 is market analysis and actual injury. If you read the question again on Instruction - they say 18 - if you read it, 17 tells us that B&W did not have to have market power. And then it goes on and says - and on Instruction 17 tells us that

B&W did have to have market power. If you read 17 as 18, the

\* \* \*

**[Jury Instructions: Written]**

Members of the Jury:

Now that you have heard all of the evidence and the argument of counsel, it becomes my duty to give you the instructions of the Court concerning the law applicable to this case.

It is your duty as jurors to follow the law as I shall state it to you, and to apply that law to the facts as you find them from the evidence in the case. You are not to single out one instruction alone as stating the law, but must consider the instructions as a whole. Neither are you to be concerned with the wisdom of any rule of law stated by me. Regardless of any opinion you may have as to what the law is or ought to be, it would be a violation of your sworn duty to base a verdict upon any view of the law other than that given in the instructions of the Court, just as it would also be a violation of your sworn duty, as judges of the facts, to base a verdict upon anything other than the evidence in the case.

In deciding the facts of this case you must not be swayed by bias or prejudice or favor as to any party. Our system of law does not permit jurors to be governed by prejudice or sympathy or public opinion. Both the parties and the public expect that you will carefully and impartially consider all of the evidence in the case, follow the law as stated by the Court, and reach a just verdict regardless of the consequences.

This case should be considered and decided by you as an action between persons of equal standing in the community, and holding the same or similar stations in life. A corporation is entitled to the same fair trial at your hands as is a private individual. The law is no respecter

of persons, and all persons, including corporations, stand equal before the law and are to be dealt with as equals in a court of justice.

When a corporation is involved, of course, it may act only through natural persons as its agents or employees; and, in general, any agent or employee of a corporation may bind the corporation by his acts and declarations made while acting within the scope of his authority delegated to him by the corporation, or within the scope of his duties as an employee of the corporation.

As stated earlier, it is your duty to determine the facts, and in so doing you must consider only the evidence I have admitted in the case. The term "evidence" includes the sworn testimony of the witnesses and the exhibits admitted in the record.

Remember that any statements, objections or arguments made by the lawyers are not evidence in the case. The function of the lawyers is to point out those things that are most significant or most helpful to their side of the case, and in so doing, to call your attention to certain facts or inferences that might otherwise escape your notice.

In the final analysis, however, it is your own recollection and interpretation of the evidence that controls in the case. What the lawyers say is not binding upon you. Also, during the course of a trial I occasionally make comments to the lawyers, or ask questions of a witness, or admonish a witness concerning the manner in which he should respond to the questions of counsel. Do not assume from anything I may have said that I have any opinion concerning any of the issues in this case. Except for my



instructions to you on the law, you should disregard anything I may have said during the trial in arriving at your own findings as to the facts.

So, while you should consider only the evidence in the case, you are permitted to draw such reasonable inferences from the testimony and exhibits as you feel are justified in the light of common experience. In other words, you may make deductions and reach conclusions which reason and common sense lead you to draw from the facts which have been established by the testimony and evidence in the case.

Now, I have said that you must consider all of the evidence. This does not mean, however, that you must accept all of the evidence as true or accurate.

You are the sole judges of the credibility or "believability" of each witness and the weight to be given to his testimony. In weighing the testimony of a witness you should consider his relationship to the Plaintiff or to the Defendant; his interest, if any, in the outcome of the case; his manner of testifying; his opportunity to observe or acquire knowledge concerning the facts about which he testified; his candor, fairness and intelligence; and the extent to which he has been supported or contradicted by other credible evidence. You may, in short, accept or reject the testimony of any witness in whole or in part.

Also, the weight of the evidence is not necessarily determined by the number of witnesses testifying as to the existence or non-existence of any fact. You may find that the testimony of a smaller number of witnesses as to any fact is more credible than the testimony of a larger number of witnesses to the contrary.

A witness may be discredited or "impeached" by contradictory evidence, by a showing that he testified falsely concerning a material matter, or by evidence that at some other time the witness has said or done something, or has failed to say or do something, which is inconsistent with the witness' present testimony.

If you believe that any witness has been so impeached, then it is your exclusive province to give the testimony of that witness such credibility or weight, if any, as you may think it deserves.

The rules of evidence provide that if scientific, technical, or other specialized knowledge might assist the jury in understanding the evidence or in determining a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify and state his opinion concerning such matters.

You should consider each expert opinion received in evidence in this case and give it such weight as you may think it deserves. If you should decide that the opinion of an expert witness is not based upon sufficient education and experience, or if you should conclude that the reasons given in support of the opinion are not sound, or that the opinion is outweighed by other evidence, then you may disregard the opinion entirely.

The burden is on the Plaintiff in a civil action such as this to prove every essential element of his claim by a "preponderance of the evidence." A preponderance of the evidence means such evidence as, when considered and compared with that opposed to it, has more convincing force and produces in your minds a belief that what is sought to be proved is more likely true than not true. In

other words, to establish a claim by a "preponderance of the evidence" merely means to prove that the claim is more likely so than not so.

In determining whether any fact in issue has been proved by a preponderance of the evidence, the jury may consider the testimony of all the witnesses, regardless of who may have called them, and all the exhibits received in evidence, regardless of who may have produced them. If the proof should fail to establish any essential element of Plaintiff's claim by a preponderance of the evidence, the jury should find for the Defendant as to that claim.

There are, generally speaking, two types of evidence from which a jury may properly find the truth as to the facts of a case. One is direct evidence - such as the testimony of an eyewitness. The other is indirect or circumstantial evidence - the proof of a chain of circumstances pointing to the existence or non-existence of certain facts.

The law makes no distinction between direct or circumstantial evidence, but simply requires that the jury find the facts in accordance with the preponderance of all the evidence in the case, both direct and circumstantial.

The difference between direct and circumstantial evidence can be demonstrated by a simple analogy. Suppose a mother baked a chocolate cake for dessert and she left it in the house and went out for a while, and when she came back she found a big piece of the cake missing. And she calls her son and she says, "Johnny, did you eat the cake I made for supper?" and he says, "No, Mother, I didn't eat the cake." Well, suppose his little sister comes

running up and says: "Yes, he did, too. I saw him eat the cake." Now that is direct evidence.

Well, let's suppose there's no little sister around to tell on him and he denies eating the cake, and the mother says, "Johnny, let me see your hands." And he holds out his hands and there's chocolate on them, and she looks at his lips and she sees crumbs. Well now, she hasn't seen him eat the cake but she's seen evidence from which she can conclude that he ate the cake. That is circumstantial evidence.

Also, during the trial I instructed you that some documents and statements were admitted for a limited purpose only and not, in some instances, for the truth of the statements therein, and you must follow that instruction.

When attorneys on both sides agree or stipulate to a fact, you should accept that stipulation as true, and regard the fact as proven.

During the trial of this case, certain testimony has been presented to you by way of deposition, consisting of sworn recorded answers to question asked of the witness in advance of the trial by one or more of the attorneys for the parties to the case. Such testimony is entitled to the same consideration, and is to be judged as to credibility, and weighed, and otherwise considered by the jury, insofar as possible, in the same way as if the witness had been presented, and had testified from the witness stand.

Of course, the fact that I have given you instructions concerning the issue of Plaintiff's damages should not be

interpreted in any way as an indication that I believe that Plaintiff should, or should not, prevail in this case.

Your verdict must represent the considered judgment of each juror. In order to return a verdict, it is necessary that each juror agree thereto. In other words, your verdict must be unanimous.

It is your duty as jurors to consult with one another and to deliberate with a view to reaching an agreement if you can do so without violence to individual judgment. Each of you must decide the case for yourself, but only after an impartial consideration of all the evidence in the case with your fellow jurors. In the course of your deliberations, do not hesitate to re-examine your own views, and change your opinion, if convinced it is erroneous. But do not surrender your honest conviction as to the weight or effect of the evidence, solely because of the opinion of your fellow jurors, or for the mere purpose of returning a verdict.

Remember at all times you are not partisans. You are judges – judges of the facts. Your sole interest is to seek the truth from the evidence in the case.

Upon retiring to the jury room you should first select one of your number to act as your foreman or forewoman who will preside over your deliberations and will be your spokesman here in court. A form of verdict has been prepared for your convenience.

(Explain verdict)

You will take the verdict form to the jury room and when you have reached unanimous agreement as to your

verdict, you will have your foreman fill it in, date and sign it, and then return to the courtroom.

If, during your deliberations, you should desire to communicate with the Court, please reduce your message or question to writing signed by the foreman or forewoman, and pass the note to the marshal who will bring it to my attention. I will then respond as promptly as possible, either in writing or by having you returned to the courtroom so that I can address you orally. I caution you, however, with regard to any message or question you might send, that you should never state or specify your numerical division at the time.

#### INSTRUCTION NO. 1

##### Opening Background

Liggett & Myers contends that Brown & Williamson's volume rebates on its black and white cigarettes in 1984 and 1985 constituted price discrimination in violation of the Robinson-Patman Act and that it is entitled to damages as a result. On the other hand, Brown & Williamson contends that it did not violate the Robinson-Patman Act and that any loss suffered by Liggett & Myers was due to vigorous competition, changes in consumer demand, and other lawful reasons.

It is my job to inform you what the law is and it is your job to apply the law to the facts as you see them. First, I would like to tell you generally what the Robinson-Patman Act provides and what must be shown for Liggett & Myers to recover damages.



INSTRUCTION NO. 2Text of § 2(a)

As you know, Liggett & Myers contends that Brown & Williamson violated the Robinson-Patman Act in connection with Brown & Williamson's sales of black and white cigarettes in 1984 and 1985. Section 2(a) of the Robinson-Patman Act states:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, . . . and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . . .

INSTRUCTION NO. 3Elements of § 2(a)

In order to establish its claim under the Robinson-Patman Act, Liggett & Myers must prove, with respect to a set of compared black and white cigarette purchases, each of the following elements by a preponderance of the evidence:

1. That at least one of the sales being compared was made across a state line;

2. That each sale was for use or resale in the U.S.;
3. That the products sold were physical items;
4. That the sales being compared were made by Brown & Williamson at about the same time;
5. That the products involved in the sales being compared were of like grade and quality;
6. That Brown & Williamson charged discriminatory - that is different - net prices to different purchasers in actual sales transactions;
7. That there is a reasonable possibility that the discriminatory pricing may harm competition in the cigarette market; and
8. That Liggett & Myers was injured in its business or property because of Brown & Williamson's discriminatory pricing.

If you find that the evidence is insufficient to prove any one or more of these elements, then you must find for Brown & Williamson and against Liggett & Myers on the Robinson-Patman Act claim.

INSTRUCTION NO. 4

SUBJECT: Robinson-Patman Act, § 2(a):  
Undisputed Elements

Several of the elements of Liggett & Myers' Robinson-Patman Act claim against Brown & Williamson are

undisputed. These undisputed elements shall not be considered by you in your deliberations. You are instructed to find that:

1. At least one of the sales of Brown & Williamson black and white cigarettes was made across a state line;
2. That each pertinent sale of Brown & Williamson black and white cigarettes was for use and resale in the U.S.;
3. That the black and white cigarettes sold were physical items;
4. That the black and white cigarette sales being compared were made by Brown & Williamson at about the same time;
5. That the black and white cigarettes involved in the sales being compared were of like grade and quality; and
6. That, in the sale of black and white cigarettes Brown & Williamson charged discriminatory – that is different – net prices to different purchasers in actual sales transactions.

You shall not consider any of these issues in determining whether Brown & Williamson violated the Robinson-Patman Act.

#### INSTRUCTION NO. 5

##### Disputed Elements

Section 2(a) of the Robinson-Patman Act does not make all discriminations in price concerning goods of like grade and quality unlawful. By itself, there is nothing

illegal about a company engaging in price discrimination. Rather, a price discrimination, within the meaning of § 2(a) of the Robinson-Patman Act, is merely a price difference and nothing more.

In order for you to find that Liggett & Myers has established a claim under the Robinson-Patman Act, Liggett & Myers must show by a preponderance of the evidence:

1. That Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market; and
2. That Liggett & Myers was injured in its business or property because of the discriminatory pricing of Brown & Williamson in the sale of black and white cigarettes.

These are the disputed issues in the case which you must decide. If you find that the evidence is insufficient to establish either one of these elements, you must find for Brown & Williamson and against Liggett & Myers.

#### INSTRUCTION NO. 6

##### Definition of Market and Submarket

Before instructing you further on the disputed issues which you must decide, it is imperative that you understand what a market and a submarket is and the importance of these concepts to your consideration of the issues in this case.

The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of supply and demand between the product itself and substitutes for it.

Within the broad market, well-defined submarkets may also exist which, in themselves, constitute product markets for antitrust purposes. The boundaries of such submarkets are determined by examining various indicators such as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.

All of these factors must be examined in determining whether a well-defined submarket exists in the broader market. However, the existence of a submarket or its lack of existence does not require the presence or absence of all of the factors. The submarket test is not merely whether one product can be substituted for the use of another product, but whether products may be reasonably interchanged for the purposes for which they are produced when prices, uses, and qualities of the products are considered.

The term "submarket" is a technical term, which depends on the specific factors about which I have instructed you. It does not have the same meaning as terms you may have heard in this trial, such as "segment" or "category." Thus, the fact that witnesses and lawyers may refer to a "value-for-money segment" does not necessarily have any economic significance and does not establish the existence of a submarket.

I have previously instructed you that one of the relevant factors in determining whether there is a submarket in this case is whether the industry or the public recognizes low-priced cigarettes as a separate and distinct economic entity. This is only one of the factors that you must consider, and you may not find the existence of a submarket based upon consideration of this factor alone. Your decision on this question must be based on a consideration of all the economic factors on which I have previously instructed you.

#### INSTRUCTION NO. 7

##### Example of Market and Submarket

An example of a market and a submarket may further your understanding of these difficult economic concepts. For instance, when you shop at the grocery store, lemon products are a separate market since no other goods serve the same purposes and uses which lemons do. In the broad lemon market, there are also well-defined submarkets such as the fresh lemon submarket and the reconstituted lemon juice submarket. Although the end use by consumers of fresh lemons and reconstituted lemon juice is often the same, there are important distinctions between the two products such as price, consumer and industry perception, packaging, production facilities, quality, distribution, and spoilage. Because of these distinctions, despite the similarity in end use by consumers, fresh lemons and reconstituted lemon juice are different submarkets of the same broad lemon products market.



Lemons, of course, have nothing to do with this case. They serve just as an example to aid your understanding of what a market and submarket is.

#### INSTRUCTION NO. 8

##### Counterexample

Submarkets do not exist in every market. For example, 32 ounce soft drink bottles are not a well-defined submarket of the soft drink bottle market. The reason is that 16 and 64 ounce soft drink bottles are ready substitutes for 32 ounce soft drink bottles. Although size is a unique characteristic of 32 ounce soft drink bottles, few other notable distinctions exist between 32 ounce soft drink bottles and 16 and 64 ounce soft drink bottles since contents, packaging, end use, vendors, consumer and industry perception, and sensitivity to price changes are all the same. Therefore, 32 ounce soft drink bottles are not a well-defined submarket of the soft drink bottle market. As with lemons, 32 ounce soft drink bottles have nothing to do with this case. They only serve as an illustration that not all markets have well-defined submarkets.

#### INSTRUCTION NO. 9

##### Relevant Market and Submarkets

The broad market, in which Liggett & Myers claims that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition, is the market for all cigarettes - branded and price-value - in the United States.

Neither Liggett & Myers nor Brown & Williamson dispute that the relevant market in which to evaluate a reasonable possibility of injury to competition is all cigarettes.

Liggett & Myers contends that price-value cigarettes are a well-defined submarket of the cigarette market. Brown & Williamson disputes this. The term price-value cigarettes means the generic portion of the cigarette market and both black and white and branded generic cigarettes are properly included under the price-value label.

You must decide two things:

1. Are price-value cigarettes a well-defined submarket of the cigarette market?; and
2. Was there a reasonable possibility of injury to competition in the cigarette market as a whole due to Brown & Williamson's price-value activity.

Your answers to these two questions are important. I will instruct you later how your answers to these questions will affect the evidence you will consider in determining whether Brown & Williamson violated the Robinson-Patman Act.

#### INSTRUCTION NO. 10

##### Competitive Injury Requirement

Once you have considered the market/submarket questions, you must distinguish between conduct which is lawful competition and conduct which is unlawful competition. Please note that mere diversion of business

from one competitor to other competitors is not in and of itself unlawful.

The first element you must consider in determining whether Brown & Williamson violated the Robinson-Patman Act is whether Liggett & Myers has shown, by a preponderance of the evidence, that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

#### INSTRUCTION NO. 11

##### Meaning of Reasonable Possibility

By reasonable possibility I mean just that. It is not necessary for Liggett & Myers to establish that Brown & Williamson's price discrimination actually injured competition. Liggett & Myers need only show that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market.

On the other hand, Liggett & Myers must show more than a mere possibility of injury to competition in the cigarette market. There must be a reasonable possibility of injury to competition. Of course, if Liggett & Myers shows that actual injury to competition in the cigarette market occurred due to Brown & Williamson's price discrimination in the sale of black and white cigarettes, then the reasonable possibility of injury to competition element is satisfied.

#### INSTRUCTION NO. 12

##### Meaning of Injury to Competition

By injury to competition, I mean the injury to consumer welfare which results when a competitor is able to

raise and to maintain prices in a market or well-defined submarket above competitive levels. In order to injure competition in the cigarette market as a whole, Brown & Williamson must be able to create a real possibility of both driving out rivals by loss-creating price cutting and then holding on to that advantage to recoup losses by raising and maintaining prices at higher than competitive levels.

You must remember that the Robinson-Patman Act was designed to protect competition rather than just competitors and, therefore, injury to competition does not mean injury to a competitor. Liggett & Myers can not satisfy this element simply by showing that they were injured by Brown & Williamson's conduct. To satisfy this element, Liggett & Myers must show, by a preponderance of the evidence, that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market and not just a reasonable possibility of injuring a competitor in the cigarette market.

#### INSTRUCTION NO. 13

##### Threshold Requirement of Market Power

Earlier I instructed you to determine whether price-value cigarettes are a well-defined submarket of the cigarette market. Your decision on that question will be very important in determining whether Brown & Williamson's activity had a reasonable possibility of injuring competition in the cigarette market.

If you determine that price-value cigarettes are a well-defined submarket of the cigarette market, then as a

threshold matter, before examining the injury to competition element of Liggett & Myers' Robinson-Patman Act claim, I charge you that Brown & Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown & Williamson had market power, or a realistic prospect of obtaining market power, in either a well-defined price-value submarket or the cigarette market as a whole.

If you determine that price-value cigarettes are not a well-defined submarket of the cigarette market, then as a threshold matter, before examining the injury to competition element of Liggett & Myers' Robinson-Patman Act claim, I charge you that Brown & Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown & Williamson had market power, or a realistic prospect of obtaining market power, in the cigarette market as a whole.

#### INSTRUCTION NO. 14

##### Market Power distinguished from Market Share

Market power must be distinguished from market share. Market share is the percent of sales a company has in a market or submarket compared to its competitors. For example, if a company has a 20% market share its competitors have an 80% market share.

On the other hand, market power is the power of a company to control prices and to exclude rivals in a market or well-defined submarket. The power to control prices is simply the ability of a company to establish and to maintain higher price points for its products in a

market or well-defined submarket without suffering a loss of business to its rivals. The power to exclude rivals means the ability of a company to discipline or exclude existing rivals and to prevent new rivals from entering the market or well-defined submarket. If other rivals can with reasonable ease take the place of any excluded or disciplined competitors, then competition can not be injured in a market or a well-defined submarket.

#### INSTRUCTION NO. 15

##### Importance of Market Power

For Robinson-Patman Act purposes, market power is the relevant concept you must closely examine. The market share of a company is one factor – not the only one – which can help you determine whether that company possesses market power. If you find that Brown & Williamson did not possess market power, then you must find for Brown & Williamson and against Liggett & Myers on the Robinson-Patman Act claim. This is because Liggett & Myers can not demonstrate that Brown & Williamson had a reasonable possibility of injuring competition in the cigarette market, unless Brown & Williamson possessed market power.

#### INSTRUCTION NO. 16

##### Alternative Methods of Proving Reasonable Possibility of Injury to Competition

If you determine that Brown & Williamson possessed sufficient market power, then a reasonable possibility of



injuring competition in the cigarette market can be shown in either one of two ways:

1. Liggett & Myers may show through market analysis that Brown & Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market; or
2. Liggett & Myers may show that Brown & Williamson had predatory intent, from which you may infer that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

#### INSTRUCTION NO. 17

##### Proof of Reasonable Possibility of Injury to Competition through Market Analysis

The first way for Liggett & Myers to establish that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through market analysis. Market analysis is looking at what actually happened in the cigarette market over a relevant time period to determine whether Brown & Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market as a whole.

In making this determination, you should consider whether the cigarette market was more competitive before or after Brown & Williamson's entry into the price-value business. In this regard, you may wish to consider

changes in cigarette prices as a whole and the availability of any special promotions, as well as the relative price differences between full-revenue branded and price-value cigarettes.

If you find that Liggett & Myers has established through a preponderance of the evidence, that Brown & Williamson's conduct actually injured competition in the cigarette market, then the reasonable possibility of injury to competition element is satisfied and you need not consider whether Brown & Williamson had predatory intent.

#### INSTRUCTION NO. 18

##### Proof of Reasonable Possibility of Injury to Competition through Predatory Intent

The second way for Liggett & Myers to establish that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through an examination of Brown & Williamson's intent when it entered the black and white cigarette business. Predatory intent, from which a reasonable possibility of injury to competition may be inferred, can be shown in either one of two ways:

1. Predatory intent may be inferred from proof that Brown & Williamson priced its relevant cigarette product below the reasonably anticipated average variable cost of manufacturing and selling that product over a relevant time period; and/or

2. Predatory intent may be found through direct evidence of Brown & Williamson's statements, documents or conduct.

You must remember that no matter what you decide about whether Brown & Williamson possessed predatory intent, you may only infer a reasonable possibility of injury to competition in the cigarette market from predatory intent if you find that Brown & Williamson had sufficient market power.

#### INSTRUCTION NO. 19

##### Predatory Intent and Predatory Pricing Defined

Predatory intent is the state of mind in which a company plans to discipline and to exclude rivals from a market or a well-defined submarket so that it can earn higher than competitive profits on its products in that market or well-defined submarket.

Predatory pricing happens when a company foregoes short-term profits in order to develop a market position such that the company can later raise prices and recoup profits. Predatory pricing differs from healthy competitive pricing in its motive: a predator by its pricing seeks to impose losses on other firms, not garner gains for itself. Price reductions that constitute a legitimate, competitive response to market conditions are not predatory.

#### INSTRUCTION NO. 20

##### Inferences

To infer a fact is to make a reasoned, logical conclusion that a disputed fact exists on the basis of another fact

which has been shown to exist. The process of drawing inferences from facts in evidence is not a matter of guesswork or speculation. An inference is a deduction or conclusion which you, the jury, are permitted – but not required – to draw from the facts which have been established by either direct or circumstantial evidence. In drawing inferences, you should exercise your common sense. For example, an inference of decreased competition may be overcome by evidence indicating that competition actually increased.

#### INSTRUCTION NO. 21

##### Average Variable Cost Test

If you determine that Brown & Williamson possessed market power, the law allows you to infer that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market as long as you find that Brown & Williamson acted with predatory intent. There are two ways that Liggett & Myers can show predatory intent. I will now instruct you on the first way – the average variable cost test.

Earlier I instructed you that you must determine whether price-value cigarettes are a well-defined submarket of the cigarette market. This decision is crucial to your proper application of the average variable cost test. I will explain the average variable cost test to you shortly. But right now you must understand that you can not apply this test correctly until you determine whether price-value cigarettes are a well-defined submarket of the cigarette market.

If you find that price-value cigarettes are a well-defined submarket of the cigarette market, then, in applying the average variable cost test, you must look at whether Brown & Williamson priced its black and white cigarettes below reasonably anticipated average variable cost. If you find that Brown & Williamson did price its black and white cigarettes below reasonably anticipated average variable cost, then you may – but need not – infer that Brown & Williamson had predatory intent.

On the other hand, if you find that price-value cigarettes are not a well-defined submarket of the cigarette market, then you should not apply the average variable cost test since there is no evidence that Brown & Williamson priced its full line of cigarettes – branded and price-value – below reasonably anticipated average variable cost.

The average variable cost test is a double inference test because if you find that Brown & Williamson priced below its reasonably anticipated average variable cost, you may infer that Brown & Williamson had predatory intent, and from predatory intent, you may infer that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market.

#### INSTRUCTION NO. 22

##### Definition of Average Variable Costs

Now I would like to take a moment and explain the component parts of the average variable cost test to you. Costs are divided into fixed costs and variable costs.

Fixed costs do not vary with the number of goods that a company produces and sells. Because these costs are incurred regardless of the quantity of product sold, you should not consider fixed costs in deciding whether Brown & Williamson's prices were predatory.

Variable costs, on the other hand, are those costs that increase or decrease directly with changes in output. Average variable cost is the sum of all variable costs divided by the total number of units of output in a relevant time period. Remember variable costs – those costs that change directly with a company's output – are the only relevant costs for purposes of the average variable cost test.

The determination of which costs are variable and which are fixed is a matter for you to decide. You should only apply the test if you find that price-value cigarettes are a well-defined submarket of the cigarette market. If so, to apply the test, you must determine what Brown & Williamson's average variable cost was for black and white cigarettes and then determine whether the net prices Brown & Williamson charged for its black and white cigarettes were above or below reasonably anticipated average variable cost.

#### INSTRUCTION NO. 23

##### Definition of Price

Once you have determined Brown & Williamson's reasonably anticipated average variable cost, you must decide whether or not Brown & Williamson priced below



reasonably anticipated average variable cost. Price here means the net price.

Net price equals list price minus all discounts to the customer. You must remember that customer means the wholesalers and the direct buying retailers to whom Brown & Williamson directly sold its black and white cigarettes. You should not equate customer with consumer.

#### INSTRUCTION NO. 24

##### Detailed Explanation of Average Variable Cost Calculation

Remember there are several steps you must go through in applying the average variable cost test.

1. You must decide whether price-value cigarettes are a well-defined submarket of the cigarette market.
2. If you find that price-value cigarettes are a well-defined submarket, then you must decide the total net price of Brown & Williamson's black and white cigarettes. You do this by determining the dollar value of Brown & Williamson's black and white cigarette sales in the United States over a relevant time period.
3. Then you must calculate the reasonably anticipated average variable cost of Brown & Williamson's total black and white cigarette output in the U.S..
4. You calculate this by adding up all the reasonably anticipated variable costs Brown &

Williamson spent in manufacturing and selling black and white cigarettes in the United States over the same relevant time period which you used in deciding Brown & Williamson's total dollar sales.

5. Then you compare your total price figure as measured by sales over a relevant time period with your reasonably anticipated total variable cost figure as measured over the same relevant time period. Only if Brown & Williamson's black and white cigarettes are priced below reasonably anticipated average variable cost may you infer predatory intent from this cost-pricing evidence.
6. If you find that price-value cigarettes are not a well-defined submarket of the cigarette market, then you must not apply the average variable cost test since there is no evidence that Brown & Williamson priced its full line of cigarettes - branded and price-value - below reasonably anticipated average variable cost.

#### INSTRUCTION NO. 25

##### Relevant Time Period

Liggett & Myers contends that the appropriate time period for determining whether Brown & Williamson priced below its reasonably anticipated average variable cost is the 18-month period from June 1984 through December 1985.

Brown & Williamson, on the other hand, contends that you should look at the entire period from June 1984

to present, or at least from June 1984 through June 1987, to determine whether Brown & Williamson priced below its reasonably anticipated average variable cost.

It is for you to decide what the relevant period of time is for determining whether Brown & Williamson priced below its reasonably anticipated average variable cost. In determining the relevant time period, you may use Liggett & Myers' time period, or you may use either of Brown & Williamson's time periods, or you may arrive at a different time period which you consider relevant.

#### INSTRUCTION NO. 26

##### Reasonably Anticipated Average Variable Cost

In determining whether prices are predatory, you must look at what Brown & Williamson reasonably believed its net prices and average variable cost would be. If you find that Brown & Williamson reasonably believed that its average variable cost would not exceed its net prices, but, that for unforeseen reasons, its average variable cost actually did exceed its net prices, but, that for unforeseen reasons, its average variable cost actually did exceed its net prices, then you must find that Brown & Williamson did not price below its reasonably anticipated average variable cost.

#### INSTRUCTION NO. 27

##### Possible Justification for Pricing below Average Variable Cost

You must remember that the average variable cost test only creates an inference of predatory intent. Even if

you find that Brown & Williamson priced its black and white cigarettes below its reasonably anticipated average variable cost, you may reject the inference of predatory intent. For example, this inference may be rejected if you find that Brown & Williamson was attempting to gain entry into a new portion of the cigarette business and offered net prices below reasonably anticipated average variable cost on an introductory basis only.

#### INSTRUCTION NO. 28

##### LIFO

Also, you may if you wish reject an inference of predatory intent, if you find that a substantial motivation for Brown & Williamson's entry into black and white cigarettes was LIFO decrement avoidance tax benefits.

In your deliberations you should consider, for example:

1. Whether Brown & Williamson actually obtained LIFO decrement avoidance tax benefits as a result of selling black and white cigarettes; or
2. Whether Brown & Williamson actually considered LIFO decrement avoidance tax benefits when it decided to enter the black and white cigarette business; or
3. Whether LIFO decrement avoidance tax benefits were a substantial motivation for Brown & Williamson's entry into black and white cigarettes since Brown & Williamson incurred additional costs, including start-up costs, due to the generic venture which possibly offset the tax savings from LIFO decrement avoidance. Remember that start-up

costs often are used for new assets which have a long life.

#### INSTRUCTION NO. 29

##### Direct Evidence of Predatory Intent

The second way that Liggett & Myers can establish predatory intent is through direct evidence of Brown & Williamson's statements and conduct.

Statements that show predatory intent can be oral or written statements by Brown & Williamson personnel. In determining what weight to give these statements, you may consider whether the person making the statement had a voice in directing Brown & Williamson company policy and whether the person making the statement had direct responsibility for the particular subject matter in question.

Conduct can also indicate predatory intent. For example, if you find that Brown & Williamson knowingly copied Liggett & Myers' quality seal and leaf design, you may consider this as some direct evidence that Brown & Williamson acted with predatory intent. You must determine the weight to give to Brown & Williamson's conduct.

#### INSTRUCTION NO. 30

##### Caution about Direct Evidence

When you consider direct evidence of predatory intent, you must be very cautious. The true intent of statements and conduct is often difficult to discern. Documentary evidence of predatory intent can be especially

misleading and ambiguous because the exact meaning of words is sometimes unclear and business people often use aggressive words to describe lawful competitive activities.

For instance, I have allowed you to hear some evidence regarding U.S. Tobacco and Georgeopulo Co. for the limited purposes of 1) providing a yardstick to assist you in evaluating the competitive terminology used in business documents; and 2) evaluating the effectiveness of using lower list prices as a way of competing for consumers at retail, if you find that the experiences of U.S. Tobacco and Georgeopulo Co. were considered by Brown & Williamson when it made its pricing decisions regarding black and white cigarettes.

You must remember, as I have told you before, there is no contention in this case that Liggett & Myers' conduct with respect to U.S. Tobacco and Georgeopulo Co. injured competition in the cigarette market. Neither U.S. Tobacco nor Georgeopulo Co. have any claims against Liggett & Myers in connection with any of the evidence you have heard in this case.

#### INSTRUCTION NO. 31

##### Causation

Liggett & Myers must show more than just a reasonable possibility of injury to competition in the cigarette market in order to prove that Brown & Williamson violated the Robinson-Patman Act. The law provides that it must be the price discrimination which causes the reasonable possibility of injury to competition.



In this case, unless Liggett & Myers proves by a preponderance of the evidence that a reasonable possibility of injury to competition in the cigarette market was caused by differences in the prices Brown & Williamson charged for its black and white cigarettes, then Liggett & Myers has failed to carry its burden.

Several examples may be useful here. First, if you find that the reasonable possibility of injury to competition resulted merely from low prices, then you must find that Brown & Williamson's price discrimination did not create any reasonable possibility of injury to competition. Second, if you find that some other aspect of Brown & Williamson's conduct other than price discrimination caused a reasonable possibility of injury to competition in the cigarette market, then you must find that Brown & Williamson's price discrimination did not create a reasonable possibility of injury to competition in the cigarette market.

On the other hand, if you find that price discrimination facilitated or made possible predatory conduct by Brown & Williamson, then you may find that it was the price discrimination which caused a reasonable possibility of injury to competition in the cigarette market.

Remember, even if you decide that Brown & Williamson's conduct created a reasonable possibility of injury to competition in the cigarette market, you must find for Brown & Williamson and against Liggett & Myers if the conduct which created this threat to competition was something other than Brown & Williamson's price discrimination in the sale of black and white cigarettes.

### INSTRUCTION NO. 32

#### Robinson-Patman Act, § 2(b)

If you find that Liggett & Myers has established, by a preponderance of the evidence, the elements of its claim under the Robinson-Patman Act, that is you have found that Brown & Williamson's price discrimination had a reasonable possibility of injuring competition in the cigarette market as a whole, then you must find that Brown & Williamson has violated the Robinson-Patman Act unless Brown & Williamson has established an affirmative defense under § 2(b) of the Robinson-Patman Act.

Section 2(b) of the Robinson-Patman Act states that:

... nothing herein contained shall prevent a seller rebutting the (evidence by plaintiff indicating a possible violation of the Robinson-Patman Act) by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

An affirmative defense is one that Brown & Williamson has the burden of proving by a preponderance of the evidence.

### INSTRUCTION NO. 33

#### Meeting Competition Defense

To establish the affirmative defense of meeting competition, Brown & Williamson must show, by a preponderance of the evidence, that it lowered its net prices of black and white cigarettes to customers in good faith with

the intention to meet, but not beat, the equally low net prices of Liggett & Myers' black and white cigarettes.

Good faith is the most important element of this defense. Good faith is shown if Brown and Williamson reasonably believed, over the relevant time period, that the net prices of its black and white cigarettes were meeting, but not beating, the equally low net prices of Liggett & Myers' black and white cigarettes.

Even if the net prices of Brown and Williamson's black and white cigarettes were actually lower to customers than Liggett & Myers' net prices, the defense is not lost if Brown & Williamson establishes by a preponderance of the evidence its good faith.

#### INSTRUCTION NO. 34

##### Effect of Meeting Competition Defense

You must remember that even if all the elements of the Robinson-Patman Act are established, Brown & Williamson has an absolute affirmative defense if it shows that its black and white cigarettes' net prices were set in good faith to meet, not beat, the equally low net prices of Liggett & Myers' black and white cigarettes. If Brown & Williamson proves the meeting competition defense, by a preponderance of the evidence, you must find that Brown & Williamson did not violate the Robinson-Patman Act. Only, if you find that Brown and Williamson is not entitled to the meeting competition defense, may you consider damages.

#### INSTRUCTION NO. 35

##### Damages: General

If you find that Liggett & Myers has established by a preponderance of the evidence that Brown & Williamson violated § 2(a) of the Robinson-Patman Act, and if you find that Brown & Williamson has not proven by a preponderance of the evidence the § 2(b) affirmative defense of meeting competition, then you must consider whether Liggett & Myers is entitled to recover damages.

In order for you to determine that Liggett & Myers is entitled to damages, you must find that Liggett & Myers has proven, by a preponderance of the evidence, the following:

1. That Liggett & Myers was in fact injured in its property or business;
2. That Liggett & Myers suffered this injury due to Brown & Williamson's violation of the Robinson-Patman Act; and
3. The amount of damages that Liggett & Myers has incurred.

I will now explain each of those elements further.

#### INSTRUCTION NO. 36

##### Fact of Injury

Liggett & Myers can establish that it was injured in its business or property if, by direct reason of Brown & Williamson's violation of the Robinson-Patman Act, it shows that it suffered financial losses in the period from June 1984 through December 1985 or another shorter time period which you are free to determine. These losses may

include out-of-pocket expenses such as rebates or diminished returns on investment.

#### INSTRUCTION NO. 37

##### Antitrust Injury

Next, Liggett & Myers must show that Brown & Williamson's price discrimination was a material cause of Liggett & Myers' actual injury. In making this determination, you may consider whether explanations other than Brown & Williamson's price discrimination were the real causes of Liggett & Myers' actual injury. These alternative explanations include among others:

1. Competition by other cigarette manufacturers for full revenue branded sales; or
2. Falling consumer demand in the cigarette market; or
3. Liggett & Myers own management shortcomings; or
4. Loss of consumer sales of black and white cigarettes which Liggett & Myers sold due to more popular branded generic cigarettes which Liggett & Myers did not sell.

You must remember that Liggett & Myers need not prove that Brown & Williamson's price discrimination was the sole cause of Liggett & Myers' actual injury. Nor must Liggett & Myers show that Brown & Williamson's price discrimination was a more substantial cause of injury than any other.

Liggett & Myers, however, must show that Brown & Williamson's price discrimination played a substantial part in causing Liggett & Myers actual injury. Therefore, Liggett & Myers may not recover damages if you find that Brown and Williamson's conduct was not a material cause of Liggett & Myers actual injury.

#### INSTRUCTION NO. 38

##### Amount of Damages

Finally, in order for Liggett & Myers to receive damages, it must provide sufficient evidence for you to determine the amount of damages it suffered from Brown & Williamson's illegal conduct. In determining a proper award of damages for Liggett & Myers, you must separate damage to Liggett & Myers from the lawful competitive activities of Brown & Williamson and the other cigarette manufacturers from damage to Liggett & Myers due to Brown & Williamson's illegal activities. Liggett & Myers may only recover damages for the illegal activities of Brown & Williamson.

Once Liggett & Myers has proven that it was in fact injured and that Brown & Williamson's conduct was a material cause of its injury, Liggett & Myers' burden of proving the amount of damages is somewhat lightened. You are allowed to determine the amount of damages Liggett & Myers incurred based on evidence which shows the extent of damages as a matter of just and reasonable inference, although the result may be only approximate.

However, this burden is not satisfied by mere speculation and guesswork. Liggett & Myers is still required



to put forward substantial and relevant evidence from which damages can be reasonably approximated.

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